Supreme Court, U. S.
FILED
APR 4 1975
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

Nos. 74-157 and 74-647

UNITED HOUSING FOUNDATION, INC., *et al.*,

Petitioners,

—v.—

MILTON FORMAN, *et al.*,

Respondents,

—and—

THE STATE OF NEW YORK and the
NEW YORK STATE HOUSING FINANCE AGENCY,

Petitioners,

—v.—

MILTON FORMAN, *et al.*,

Respondents.

RESPONDENTS' BRIEF

LOUIS NIZER
40 West 57th Street
New York, New York 10019
Attorney for Respondents

GEORGE BERGER
JAY F. GORDON
IRA B. ROSE
JANET P. KANE
THOMAS G. JACKSON
Of Counsel

INDEX

	PAGE
Questions Presented	1
Statement	2
The Parties, and the State's Proprietary Interest in Co-op City	4
The First "Information Bulletin" (Prospectus)	10
The Material Omissions	13
The Commissioner's Waiver of His Own Liquidity Rule	14
The Second "Information Bulletin" (Prospectus)	16
The Changes in the Construction Contract	17
1. The First Increase of $9,328,000	17
2. The Second Increase of $250,000	18
3. The Third Increase of $1,900,000	18
4. The Fourth Increase of $40,519,250	18
5. The Fifth Increase of $30,000,000	19
6. Increase of Service Fees by $2,510,000	20
Increases in the Mortgage	21
The Resulting Increases in Carrying Charges	21
The Securities Sold Pursuant to the Information Bulletins	22

PAGE

The True Purchase Price of Riverbay Stock Was Never Disclosed to Plaintiffs 23

The Economic Inducements Contained in the Information Bulletins 25

The Incidents of Ownership of Riverbay Stock 27

The "Profitability" of the Transaction From the Seller's Viewpoint 30

Summary of Argument 32

ARGUMENT:

POINT I

The common stock of Riverbay purchased by plaintiffs is a security within the meaning of the federal securities laws 33

A. The common stock of Riverbay is within the meaning of the term "stock" in the statutory definition of a security 33

1. The Statutory Language 34

2. The Case Law 35

3. The Legislative History 41

4. Rules and Regulations of the SEC 42

5. The State Blue Sky Statutes 46

6. The Legal Commentators 47

PAGE

B. Alternatively, the shares of common stock of Riverbay purchased by plaintiffs are "investment contracts" within the meaning of the federal securities laws 48

C. Alternatively, the shares of common stock of Riverbay purchased by plaintiffs are "instruments commonly known as a 'security'" within the meaning of the statutory definition 57

D. Congress has mandated application of the federal securities laws to interstate sales of stock regardless of state regulation 60

POINT II

The defense of immunity under the Eleventh Amendment is not available to the Agency and has been waived by the State 65

A. The Agency cannot assert the defense of Eleventh Amendment immunity 65

B. The defense of Eleventh Amendment immunity has been waived by the State both by statute and by conduct 67

1. The defense has been waived by statute 67

2. The defense has been waived by conduct 70

CONCLUSION 79

Table of Authorities

PAGE

Cases:

Addison v. Holly Hill Fruit Products, Inc., 322 U.S. 607 (1944) 34
Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972) 35, 39, 41-42
Ahrens v. American-Canadian Beaver Co., 458 F.2d 607 (10th Cir. 1970) 51
Allen v. Biltmore Tissue Corp., 2 N.Y.2d 534, 141 N.E. 2d 812 (1957) 29
Ashton v. Thorton Realty Co., 346 F. Supp. 1294 (S.D. N.Y. 1972), *aff'd*, 471 F.2d 647 (2d Cir. 1973) 41

Baron v. Shields, 131 F. Supp. 370 (S.D.N.Y. 1955) 73, 78
Bellah v. First National Bank, 495 F.2d 1109 (5th Cir. 1974) 40
Blackwell v. Bentsen, 203 F.2d 690 (5th Cir. 1953), *cert. denied*, 347 U.S. 925 (1954) 50
Bond v. Koscot Interplanetary, Inc., 276 So. 2d 198 (Fla. App. 1973) 56
Braun v. State, 203 Misc. 563, 117 N.Y.S.2d 601 (Ct. Cl. 1952) 66
Browder v. United States, 321 U.S. 335 (1941) 34

Carnation Co. v. Pacific Westbound Conference, 383 U.S. 213 (1970) 43
Charles Simkin & Sons, Inc. v. State University Construction Funds, 352 F. Supp. 177 (S.D.N.Y.), *aff'd mem.*, 486 F.2d 1393 (2d Cir. 1973) 66
Chesapeake Bay Bridge & Tunnel District v. Lauritzen, 404 F.2d 1001 (4th Cir. 1968) 74

PAGE

Ciulla v. State, 191 Misc. 528, 77 N.Y.S.2d 545 (Ct. Cl. 1948) 66
Commonwealth v. 2101 Cooperative, Inc., 27 Pa. D.&C. 2d 405 (C.P. 1961), *aff'd per curiam*, 408 Pa. 24, 183 A.2d 325 (1962) 53
C.N.S. Enterprises, Inc. v. G. & G. Enterprises, Inc., CCH Fed. Sec. L. Rep. ¶94,938 (7th Cir., Jan. 13, 1975) 40
Continental Marketing Corp. v. SEC, 387 F.2d 466 (10th Cir. 1967), *cert. denied*, 391 U.S. 905 (1968) 51

Davenport v. United States, 260 F.2d 591 (9th Cir. 1958), *cert. denied*, 359 U.S. 909 (1959) 28, 41, 51-52
DeVoe v. Ostrander, No. C-3-74-95 (S.D. Ohio, Oct. 18, 1974) 77

Edelman v. Jordan, 415 U.S. 651 (1974) 71, 76, 77, 78
El Khadem v. Equity Securities Corp., 494 F.2d 1224 (9th Cir.), *cert. denied*, 95 S. Ct. 183 (1974) 51, 55
Employees v. Missouri Public Health Department, 411 U.S. 279 (1973) 76, 77

F. D. Rich Co. v. United States *ex rel.* Industrial Lumber Co., 94 S. Ct. 2157 (1974) 3
Federal Deposit Insurance Corp. v. Winton, 131 F.2d 780 (6th Cir. 1942) 34
Ferland v. Orange Groves of Florida, Inc., 377 F. Supp. 690 (M.D. Fla. 1974) 50
Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951) 75
Flores v. Norton & Ramsey Lines, Inc., 352 F. Supp. 150 (W.D. Tex. 1972) 68

PAGE

Fratt v. Robinson, 203 F.2d 627 (9th Cir. 1953) 78
Frye v. Taylor, 263 So. 2d 835 (Fla. App. 1972) 56

Grenader v. Spitz, CCH Fed. Sec. L. Rep. ¶95,008 (S.D. N.Y., Mar. 5, 1975) 41

Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680 (5th Cir. 1971) 42
Hurst v. Dare To Be Great, Inc., 474 F.2d 484 (9th Cir. 1973) 56

International Longshoremen's Association v. North Carolina State Ports Authority, 370 F. Supp. 33 (E.D.N.C. 1974) 66, 74, 77

J. I. Case Co. v. Borak, 377 U.S. 426 (1964) 3

Katz v. Amos Treat & Co., 411 F.2d 1046 (2d Cir. 1969) 75
Kent v. Quicksilver Mining Co., 78 N.Y. 159 (1879) 68
Knight v. New York, 443 F.2d 415 (2d Cir. 1971) 69

Lehigh Valley Trust Co. v. Central National Bank of Jacksonville, 409 F.2d 989 (5th Cir. 1969) 40
Lemelson v. Ampex Corp., 372 F. Supp. 708 (E.D. Ill. 1974) 74
Lino v. City Investing Co., 487 F.2d 689 (3d Cir. 1973) .. 40
Llanos v. United States, 206 F.2d 852 (9th Cir. 1953), *cert. denied,* 346 U.S. 923 (1954) 40

MacKethan v. Virginia, 370 F. Supp. 1 (E.D. Va.), *aff'd per curiam,* Civ. No. 74-1249 (4th Cir., Dec. 23, 1974) 77
Matherson v. Long Island State Park Commission, 442 F.2d 566 (2d Cir. 1971) 66

PAGE

Mathews v. Fisher, No. C-1-74-284 (S.D. Ohio, April 16, 1974), *appeal docketed sub nom.* Yeomans v. Kentucky Department of Banking & Securities, No. 74-2003 (6th Cir., Sept. 4, 1974) 77
McClure v. First National Bank, 497 F.2d 490 (5th Cir. 1974) 40
Miller v. Central Chinchilla Group, Inc., 494 F.2d 414 (8th Cir. 1974) 51
Mincola v. Arthur-Hardgrove Co. [1964-66 Transfer Binder] CCH Fed. Sec. L. Rep. ¶91,608 (S.D.N.Y. 1965) 75
Moore v. Gorman, 75 F. Supp. 453 (S.D.N.Y. 1948) 42
Moses v. Michael, 292 F.2d 614 (5th Cir. 1969) 51
Movielab, Inc. v. Berkey Photo, Inc., 321 F. Supp. 806 (S.D.N.Y. 1970), *aff'd per curiam,* 452 F.2d 662 (2d Cir. 1971) 40, 41
Murphy v. Dare To Be Great, 3 Blue Sky L. Rep. ¶71,053 (D.C. Super. Ct. 1972) 56

Named Individual Members of the San Antonio Conservation Society v. Texas Highway Department, 446 F.2d 1013 (5th Cir. 1971), *cert. denied,* 406 U.S. 933 (1972) 74
Namet v. United States, 373 U.S. 179 (1963) 3
New York Dormitory Authority v. Span Electric Corp., 18 N.Y.2d 114, 271 N.Y.S.2d 983 (1966) 66

Olympic Capital Corp. v. Newman, 276 F. Supp. 656 (C.D. Cal. 1967) 40
Osborne v. Mallory, 86 F. Supp. 869 (S.D.N.Y. 1949) 75
Owens v. Roberts, 377 F. Supp. 45 (M.D. Fla. 1974) 74

PAGE

Parden v. Terminal Railway of Alabama Docks Department, 377 U.S. 184 (1964) 70-71, 73, 75, 76, 77
Pawgen v. Silverstein, 265 F. Supp. 898 (S.D.N.Y. 1967) 51
Pennsylvania Environmental Council, Inc. v. Bartlett, 454 F.2d 613 (3d Cir. 1971) 74
People v. Cadplaz Sponsors, Inc., 69 Misc. 2d 417, 330 N.Y.S.2d 430 (Sup. Ct. 1972) 16, 37, 46, 61
Petty v. Tennessee-Missouri Bridge Commission, 359 U.S. 275 (1959) 68
Pfeffer v. Cressaty, 233 F. Supp. 756 (S.D.N.Y. 1963) .. 75
Pine Grove Manor, Inc. v. Director, 68 N.J. Super. 135, 171 A.2d 676 (1961) 53
Prendergast v. Long Island State Park Commission, 330 F. Supp. 438 (E.D.N.Y. 1970) 66
Prentice v. Hsu, 280 F. Supp. 384 (S.D.N.Y. 1968) 40
Price v. United States, 200 F.2d 652 (5th Cir. 1953) 51
Principe Compania Naviera, S.A. v. Board of Commissioners, 333 F. Supp. 353 (E.D. La. 1971) 74

Raub v. Gerkin, 127 App. Div. 42, 111 N.Y.S. 319 (2d Dep't 1908) 68
Rivet v. East Point Maritime Corp., 325 F. Supp. 1265 (S.D. Ala. 1971) 74

SEC v. Associated Gas & Electric Co., 99 F.2d 795 (2d Cir. 1938) 43
SEC v. Bailey, 41 F. Supp. 647 (S.D. Fla. 1941) 50-51
SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963) 35
SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943) 34, 35, 51

PAGE

SEC v. Crude Oil Corp., 93 F.2d 844 (7th Cir. 1937) 42
SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973) 50
SEC v. Glenn W. Turner Enterprises, Inc., 348 F. Supp. 766 (D. Ore. 1972), *aff'd*, 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973) 57
SEC v. Gulf International Finance Corp., 233 F. Supp. 987 (S.D. Fla. 1963) 40
SEC v. McElvain, 417 F.2d 1132 (5th Cir.), *cert. denied* 397 U.S. 972 (1969) 51
SEC v. Orange Grove Tracts, 210 F. Supp. 81 (D. Mass. 1962) 50
SEC v. Payne, 35 F. Supp. 873 (S.D.N.Y. 1940) 42
SEC v. Tung Corp., 32 F. Supp. 371 (N.D. Ill. 1940) 42, 51
SEC v. United Benefit Life Insurance Co., 387 U.S. 202 (1967) 50
SEC v. Universal Serv. Ass'n, 106 F.2d 232 (7th Cir. 1939), *cert. denied*, 308 U.S. 622 (1940) 42
SEC v. Variable Annuity Life Insurance Co., 359 U.S. 640 (1959) 50, 61
SEC v. W. J. Howey Co., 328 U.S. 293 (1946) 39, 48, 50, 54, 58
Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811, 361 P.2d 906 (1961) 28, 46, 53, 54
Sire Plan Portfolios, Inc. v. Carpentier, 8 Ill. App. 2d 354 (1956) 47
State *ex rel.* Commissioner of Securities v. Hawaii Market Center, Inc., 52 Hawaii 642, 485 P.2d 105 (1971) 56
State *ex rel.* Healy v. Consumer Business Systems, Inc., 482 P.2d 549 (Ore. Ct. App. 1971) 56

PAGE

State *ex rel.* Park v. Glenn Turner Enterprises, Inc., 3 Blue Sky L. Rep. ¶71,020 (Idaho Dist. Ct. 1972) 56
State *ex rel.* Russell v. Sweeney, 153 Ohio St. 66, 91 N.E.2d 13 (1950) 53
State *ex rel.* Troy v. Lumbermen's Clinic, 186 Wash. 384, 58 P.2d 812 (1936) 52
State University of New York v. Syracuse University, 206 Misc. 1003, 137 N.Y.S.2d 916 (Sup. Ct.), *aff'd*, 285 App. Div. 59, 135 N.Y.S.2d 539 (3d Dep't 1954) ..66-67
Stockton v. Lucas, 482 F.2d 979 (Temp. Emer. Ct. App. 1973) 34, 41, 43
Story House Corp. v. New York Job Development Authority, 37 App. Div. 2d 345, 325 N.Y.S.2d 659 (3d Dep't 1971), *aff'd mem.*, 31 N.Y.2d 942, 340 N.Y.S. 2d 929 (1972) 66
Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971) 35

Tcherepnin v. Knight, 389 U.S. 332 (1967) 33, 35, 37, 38, 42, 43, 50, 61
1050 Tenants Corp. v. Jakobson, 503 F.2d 1375 (2d Cir. 1974) 34, 40, 41
Thiele v. Shields, 131 F. Supp. 416 (S.D.N.Y. 1955) 75

U of F Students Cooperative, [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶78,347 (S.E.C. 1971) 41
United States v. American Trucking Associations, Inc., 310 U.S. 534 (1940) 34

Venture Investment Co., Inc. v. Schaefer, 3 Blue Sky L. Rep. ¶71,031 (D. Colo. 1972), *aff'd*, 478 F.2d 156 (10th Cir. 1973) 56

PAGE

Vincent v. P. R. Matthews Co., 126 F. Supp. 102 (N.D. N.Y. 1954) 68

Walker Process Equip., Inc. v. Food Mach. & Chem. Corp., 382 U.S. 172 (1965) 13
Whitlow & Associates, Ltd. v. Intermountain Brokers, Inc., 252 F. Supp. 943 (D. Hawaii 1966) 40
Whitten v. State University Construction Fund, 493 F.2d 177 (1st Cir. 1974) 66

Zeidner v. Wulforst, 197 F. Supp. 23 (E.D.N.Y. 1961) .. 66

Constitutional Provisions:

United States Constitution, Amend. 11 .....2, 65, 66, 70, 71, 73, 74, 78
United States Constitution, Amend. 14 3

Statutes:

Civil Rights Act of 1871, 42 U.S.C. §1983 3
Federal Employers Liability Act, 45 U.S.C. §51 *et seq.* 73, 75
Housing and Urban Development Act of 1974, 42 U.S.C. §3532 64
Internal Revenue Code of 1954 §216, 26 U.S.C. §216 51
N.Y. Abandoned Property Law §215 (McKinney Supp. 1974) 69
N.Y. Agriculture & Marketing Law §27(13) (McKinney 1972) 69
N.Y. Canal Law §§40(14), 85, 120 (McKinney Supp. 1974) 70

PAGE

N.Y. Correction Law §21 (McKinney 1968) 70
N.Y. Education Law §307(13) (McKinney 1969) 70
N.Y. Environmental Conservation Law §§15-1717(4), 15-1739(6) 70
N.Y. General Business Law §352-e (McKinney 1968, Supp. 1974) 37, 46, 60
N.Y. Highway Law §29(14) (McKinney 1962) 70
N.Y. Laws, 1926, ch. 823,
§16, 21, 38(8), 42 7
§30(2) 76
N.Y. Laws, 1968, ch. 519, §4 7
N.Y. Laws, 1968, ch. 1085 7
N.Y. Laws, 1969, ch. 528, §3 8
N.Y. Laws, 1969, ch. 1066 9
N.Y. Limited Profit Housing Companies Law,
N.Y. Laws, 1955, ch. 407 60
N.Y. Mental Hygiene Law §71.33 (McKinney Supp. 1974) 70
N.Y. Private Housing Finance Law (McKinney 1962, Supp. 1974)
§§1-59 5
§11 5
§13 ..... 8, 9
§13(7) 10
§15(c) 9
§17 8
§20(1) 8
§21 8
§22(2) 77
§25 ..... 13, 77
§26(1)(b) 13, 77

PAGE

§27 8
§28 ..... 29, 50
§29 8
§31(1) 8
§31-a 30
§32 8
§32(1) 68
§32(1)(a) 9
§32(5) 33, 65, 67, 68, 69
§32(7) 9
§35(3) 29, 50
§42(2) 8
§44 ..... 7, 65
§44(9) 8
§46(8) 7, 66
§47 7
§55 8
§85-87 7

N.Y. Public Authorities Law (McKinney 1970, Supp. 1974)
§§1682-86 (New York State Dormitory Authority) 7
§§1805-09 (New York State Job Development Autority) 7

N.Y. Public Housing Law (McKinney 1955, Supp. 1974) 5
N.Y. Real Property Actions & Proceedings Law
§1541 (McKinney 1963) 69
N.Y. State Law §59-b (McKinney 1952) 70
N.Y. Tax Law §615 (McKinney 1966, Supp. 1974) 51
Securities Act of 1933
§2(1), 15 U.S.C. §77b(1) 3, 33, 48, 57, 71
§2(2), 15 U.S.C. §77b(2) 71

PAGE

§17(a), 15 U.S.C. §77q(a) 3, 75
§17(c), 15 U.S.C. §77q(c) 42
§22(a), 15 U.S.C. §77v(a) 3

Securities Exchange Act of 1934

§3(a)(9), 15 U.S.C. §78c(a)(9) 71
§3(a)(10), 15 U.S.C. §78c(a)(10) 33, 38, 41, 48, 57, 71
§3(a)(12), 15 U.S.C. §78c(a)(12) 73
§10(b), 15 U.S.C. §78j(b) 3
§20, 15 U.S.C. §78t 3
§27, 15 U.S.C. §78aa 3

28 U.S.C. §1331 3
28 U.S.C. §1343 3

Rules:

United States Supreme Court Rule

23(1)(c) 3
40(1)(d)(2) 3

SEC Rules, Regulations, Releases and Other Materials:

American Dairy Leasing Corp., SEC Ruling (Dec. 3, 1971), [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶78,584 51
Clemson Properties, Inc., SEC No-Action Letter (Aug. 13, 1971), [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶78,387 46
Kentucky Blood Horse, Ltd., SEC Ruling (June 13, 1973), [1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶79,430 51

PAGE

McCulloch Properties, Inc., SEC No-Action Letter (Aug. 30, 1973, avail. Oct. 1, 1973) 46
900 Park Ave Corp., SEC No-Action Letter (June 9, 1972, avail. July 10, 1972) 45
Report of the Real Estate Advisory Committee to the Securities and Exchange Commission 90 n.26 (Oct. 12, 1972) 45
Rule 10b-5, 17 C.F.R. §240.10b-5 ..... 3, 39
Rule 235, 17 C.F.R. §230.235 ..... 42, 43, 44, 45
Securities Act Release No. 5223 (Jan. 11, 1972), [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶78,487 .. 44
Securities Act Release No. 5316 (Oct. 6, 1972), [1972-73 Transfer Binder] CCH Fed. Sec. L. Rep. ¶79,015 ..44-45
Securities Act Release No. 5347 (Jan. 4, 1973), [1972-73 Transfer Binder] CCH Fed. Sec. L. Rep. ¶79,163 .. 44
Securities Exchange Act Release No. 11,220 (Jan. 31, 1975), CCH Fed. Sec. L. Rep. ¶80,096 44
Society Hill Towers, Inc., SEC Ruling (Dec. 27, 1974), CCH Fed. SEC. L. Rep. ¶80,103 45

Legislative Materials:

120 Cong. Rec. 5371-72 (daily ed. June 20, 1974) 64
Hearings on H.R. 4314 Before the House Committee on Interstate and Foreign Commerce, 73d Cong., 1st Sess. (1933) 42, 73
Hearings on H.R. 7852 and 8720 Before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. (1934) 72
Hearings on S. 875 Before the Senate Committee on Banking and Currency, 73d Cong., 1st Sess. (1933) .. 73
Hearings on S. Res. 56, 84 and 97 Before the Senate Committee on Banking and Currency, 73d Cong., 1st Sess. (1933) 72, 73

PAGE

H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933) 41, 42, 71, 72
Memorandum of the Joint Legislative Committee on Housing and Multiple Dwellings (1961), *reprinted in* New York State Legislative Annual—1961 7
Report of the Joint Legislative Committee on Housing and Multiple Dwellings (1955), *reprinted in part following* N.Y. Private Housing Finance Law §10 (McKinney 1962) 7
S. Rep. No. 47, 73d Cong., 1st Sess. (1933) 41, 42, 60, 61
S. Rep. No. 792, 73d Cong., 2d Sess. (1934) 41
S. Rep. No. 1123, 90th Cong., 2d Sess. (1968) 63

Treatises, Articles and Miscellaneous Materials:

Anderson, "Cooperative Apartments in Florida: A Legal Analysis," 12 U. Miami L. Rev. 13 (1958) 47
Black's Law Dictionary (rev. 4th ed. 1968) 36, 68
Coffey, "The Economic Realities of a 'Security': Is There a More Meaningful Formula?" 18 Case W. L. Rev. 367 (1967) 54
Comment, "Securities Regulation of Real Estate Programs," 27 Ark. L. Rev. 651 (1973) 47
Guide for Development of Limited Profit Housing, Preliminary Submissions, Executive Department, State of New York, Division of Housing and Community Renewal 35 (1971) 14-15
R. Jennings & H. Marsh, Securities Regulation 300 (3d ed. 1972) 47
Hannan & Thomas, "Defining Federal Securities," 25 Hasting L.J. 219 (1974) 54
Long, "An Attempt to Return 'Investment Contracts' to the Mainstream of Securities Regulation," 24 Okla. L. Rev. 135 (1971) 54

PAGE

1 L. Loss, Securities Regulation 492-93 (2d ed. 1961) ..43, 47
1 L. Loss, Securities Regulation 40 (Supp. 1962) 43
[1972] Op. N.Y. Att'y Gen. No. 56-B 65
Note, "Cooperative Apartment Housing," 61 Harv. L. Rev. 1407 (1948) 47
Note, "Cooperative Housing Corporations and the Federal Securities Laws," 71 Colum. L. Rev. 118 (1971) 46, 54-55
Note, "Real Estate Investments as Securities: The Sufficiency of the Howey Test," 6 St. Mary's L.J. 166 (1974) 53, 55
Rifkind & Borton, "SEC Registration of Real Estate Interests: An Overview," 27 Bus. Lawyer 649 (1972) 47-48
Sobieski, "Securities Regulation in California: Recent Developments," 11 U.C.L.A. L. Rev. 1 (1963) ..46, 48
Weiss, "Real Estate or A Security," N.Y.L.J., Nov. 18, 1974, at 1, col. 1 43
Wenig & Schulz, "Government Regulation of the Condominum in California," 14 Hastings L.J. 222 (1963) 46, 48
Zammet, "Securities Law Aspects of Cooperative Housing," N.Y.L.J., Jan. 8, 1973, at 4, cols. 1-7 48

IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

Nos. 74-157 and 74-647

UNITED HOUSING FOUNDATION, INC., *et al.*,

Petitioners,

—v.—

MILTON FORMAN, *et al.*,

Respondents,

—and—

THE STATE OF NEW YORK and the
NEW YORK STATE HOUSING FINANCE AGENCY,

Petitioners,

—v.—

MILTON FORMAN, *et al.*,

Respondents.

RESPONDENTS' BRIEF

Questions Presented

1. Whether the 1,312,128 shares of common stock of a cooperative housing corporation publicly offered and sold to 15,372 separate purchasers for a $32,803,200 cash down-payment constitute "securities" within the meaning of the antifraud provisions of the federal securities laws.

2. Whether the New York State Housing Finance Agency, which is neither a "State" nor the *alter ego* of a State, can invoke the defense of immunity under the Eleventh Amendment.

3. Whether the State of New York has waived its immunity under the Eleventh Amendment by enacting Section 32(5) of the N.Y. Private Housing Finance Law or by its proprietary interest in the public sale of the common stock referred to in Question 1.

Statement

This action arises out of the public solicitation of venture capital for the construction of a mammoth cooperative housing development (P-A3).[1] The first nine counts of the amended complaint are brought on behalf of the named plaintiffs individually and as representatives of a class comprising the 15,372 subscribers to the stock of Riverbay Corporation ("Riverbay"), a cooperative corporation (A11-32). The remaining four counts are derivative claims brought on behalf of Riverbay itself (A32-37).

[1] References to the appendices to the petition for certiorari in No. 74-157 are prefaced by "P-" followed by the appendix letter and page number, *e.g.*, (P-A10). References to the Single Appendix in this case are designated by "A" followed by the page number, *e.g.*, (A2). References to the appendix submitted to the Court of Appeals below are designated by the page number followed by "a," *e.g.*, (160a). All references to the briefs of petitioners are designated as follows: Brief for Petitioners United Housing Foundation, Inc., *et al.* (UHF Brief); Brief for Petitioners the State of New York and the New York State Housing Finance Agency (N.Y. Brief); and Brief for the State of Ohio, Amicus Curiae (Ohio Brief). For reasons of clarity, the parties will be identified by their titles in the District Court. Thus, the respondents herein will be referred to as "plaintiffs" and the petitioners herein will be referred to as "defendants."

Jurisdiction of the amended complaint is invoked pursuant to Section 22(a) of the Securities Act of 1933 ("1933 Act"), 15 U.S.C. §77v(a), Section 27 of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. §78aa, and 28 U.S.C. §§1331 and 1343. The first two counts charge violations of Section 17(a) of the 1933 Act, 15 U.S.C. §77q(a); Section 10(b) of the 1934 Act, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. §240.10b-5, promulgated thereunder; and Section 20 of the 1934 Act, 15 U.S.C. §78t. The ninth count charges violations of the Civil Rights Act of 1871, 42 U.S.C. §1983.[2]

The United States District Court for the Southern District of New York dismissed the amended complaint for lack of federal jurisdiction (P-B1-29). On appeal, the United States Court of Appeals for the Second Circuit reversed unanimously (P-A1-22). A petition for rehearing and for rehearing en banc by the defendant State of New York ("State") and the defendant New York State Housing Finance Agency ("Agency") was denied unanimously by the

[2] This count is omitted from defendants' discussion of the "Statutes and Rule Involved" and the "Proceedings Below" (UHF Brief pp. 2, 6), although later acknowledged in passing (UHF Brief p. 7 n.5, N.Y. Brief p. 3). This count is asserted only against the Agency (A31). There are two underlying federally protected rights alleged therein, predicated on the securities laws of the United States and the Fourteenth Amendment (A32). Plaintiffs' argument is spelled out in detail in their reply brief in the Court of Appeals at pages 21-24. The petition for a writ of certiorari filed on behalf of the Agency does not raise any question which impairs the sufficiency of this ninth count insofar as it rests upon a Fourteenth Amendment claim. Accordingly, under this Court's rules, consideration of any such question is foreclosed. U.S. Sup. Ct. R. 23(1)(c), 40(1)(d)(2); F. D. Rich Co. v. United States *ex rel.* Industrial Lumber Co., 94 S. Ct. 2157, 2160 (1974); J. I. Case Co. v. Borak, 377 U.S. 426, 428-29 (1964); Namet v. United States, 373 U.S. 179, 190 (1963).

entire Second Circuit bench (A43). On January 20, this Court granted certiorari.

The Parties, and the State's Proprietary Interest in Co-op City

To put the appeal into proper perspective, and to furnish the context in which plaintiffs purchased Riverbay's stock, the salient facts will be reviewed, with references for each fact to both the amended complaint and the underlying documents. Virtually every material fact alleged in the amended complaint is taken verbatim from documents prepared by defendants which, by law, could not have been issued or executed without the express approval of the State or the Agency. *See* pp. 8-9, *infra*. References to the underlying documents are provided to demonstrate that there can be no dispute as to the facts, even though most of the defendants have yet to answer.

Plaintiffs seek to represent 15,372 families, many of whom invested their life savings in the purchase of stock in a low income cooperative housing project. As the District Court was "constrained to say":

> "[I]f ever there was a group of people who need and deserve full and careful disclosure in connection with proposals for the use of their funds, it is this type of group. By law, they would not be eligible for occupancy in Co-op City unless their financial resources were limited. The housing selection decision is a critical one in their lives. The cost of housing demands a good percentage of their incomes. Their savings are most likely to be minimal, and they probably don't have lawyers or accountants to guide them. Further, they are people likely to put a great deal of credence in

> statements made with respect to an offering by reputable civic groups and labor unions, particularly when the proposal is stamped with the imprimatur of the state." (P-B13).

Prior to May, 1965, defendants decided to undertake the construction of a large low-income housing development (A11 ¶12, 71a ¶13, 159a *et seq.*). This undertaking was part of the housing program of defendant United Housing Foundation ("UHF"), an amalgam of labor unions and other organizations, which had already been deeply involved in other similar projects (67a ¶4, 161a, 164a-65a). The authority for undertaking the construction and financing of this project was the New York State Mitchell-Lama Act, N.Y. Private Housing Finance Law §§1-59 (McKinney 1962, Supp. 1974) ("Private Housing Finance Law") (A9-10 ¶¶5-7, A11 ¶12, 65a, 67a, 168a).[3]

The declared purpose of the Mitchell-Lama Act is to provide "safe and sanitary dwelling accommodations for families and persons of low income, including aged persons of low income." Private Housing Finance Law §11. In keeping with that purpose, eligibility to purchase Mitchell-Lama housing is restricted to persons or families:

> "whose probable aggregate annual income at the time of admission . . . does not exceed six times the rental . . . except that in the case of families with three or

[3] Defendants refer elliptically to this statute as the "Housing Law" (UHF Brief p. 5, n.2 *et seq.*). This is misleading. New York has a number of statutes dealing with housing, including a "Public Housing Law" (McKinney 1955, Supp. 1974), which unlike the Private Housing Finance Law deals with subsidized housing. (*See* pp. 6-7, n.4, *infra*.)

more dependents, such ratio shall not exceed seven to one." *Id.* §31(2)(a).

The average carrying charge for such housing was originally represented to plaintiffs by defendants as approximately $23.02 per room per month, so that the permissible *maximum* annual earnings of a family eligible for a four-room apartment was $6,624 ($7,728 for a family of four or more). (*See Id.*; A11-12 ¶14, 174a). The plaintiffs' eligibility to purchase stock was determined against this standard and all persons earning more than the specified sums were excluded. As a result, it was predominantly retired persons on relatively low fixed incomes and young couples just starting out in life who became the purchasers (373a, P-B11-12). In sharp contrast, had the average carrying charge of $39.68 per room, which took effect on July 1, 1974, been set forth originally, the maximum permissible annual earnings for the same families in the same housing accommodations would have been $12,096 and $14,112, respectively, or nearly double the original ceiling, and people earning those larger sums would have been eligible to purchase Riverbay stock. However, they were not. The persons who were in fact eligible and did purchase the stock lacked the additional income to afford the higher carrying charges subsequently imposed (372a-74a, P-B11-12).

The Mitchell-Lama Act contemplates that the purchasers of the stock of the cooperative corporation will ultimately pay the entire cost of the housing.[4] In accordance with the

[4] *See* pp. 23-25, *infra*. Defendants repeatedly refer to the cooperative housing project as state "subsidized" (UHF Brief pp. 3, 4; N.Y. Brief p. 2). This is palpably misleading. The Mitchell-Lama Act was designed in part to provide for "State aid, *without cash subsidy provisions*, for the development of housing projects by

statute, the purchasers were required to pay down in cash at least ten percent of the total project cost[5] (168a, 171a). Private Housing Finance Law §21. The balance of the project cost was financed by the Agency by means of interest-bearing first mortgage loans to the cooperative corporation[6] (A12). The cooperative corporation in turn obtains the money to repay the mortgage through monthly carrying charges levied on plaintiffs. Private Housing Finance Law §§85-87.

The state, through its Division of Housing and Community Renewal, is entrusted with the implementation of the

housing companies formed under this Act." Report of the Joint Legislative Committee on Housing and Multiple Dwellings (1955) (emphasis added), *reprinted in part following* Private Housing Finance Law §10, at 8. Indeed, the very purpose of the statute was "to clarify the distinction between full-subsidized, low-income public housing programs administered by the State and its municipalities and *housing programs undertaken by private entrepreneurs with only limited public assistance, in the form of mortgage loans, aid in land assembly or site acquisition or tax abatement for a limited period.*" Memorandum of the Joint Legislative Committee on Housing and Multiple Dwellings (1961), *reprinted in* New York State Legislative Annual—1961, at 244, 245 (emphasis added).

[5] This percentage was later reduced by amendment to five percent. N.Y. Laws, 1968, ch. 519, §4.

[6] The State apparently chose to provide the financing through the Agency to avoid inclusion of the bond obligations as part of the State's debt. This type of financing is very common in New York. The Agency is a corporation separate from the State which obtains its funds through the sale of long-term tax-exempt bonds. The Agency's bonds are not full faith and credit bonds of the State. Private Housing Finance Law §46(8). Their tax-exempt status results in a lower interest rate than that of corporate bonds. This produces an ultimate benefit to the stockholders. For other examples of similar financing schemes, see N.Y. Public Authorities Law (McKinney 1970, Supp. 1974) §§1682-86 (New York State Dormitory Authority), §1805-09 (New York State Job Development Authority), and the statute generally. *See also* Private Housing Finance Law §§44, 47.

Mitchell-Lama Act. The Division is headed by a Commissioner who exercises all-encompassing supervisory powers (UHF Brief p. 8). No cooperative corporation can be created under this statute without his approval. Private Housing Finance Law §13.[7]

The cooperative corporation cannot borrow or give security without the Commissioner's approval (*Id.* §20(1)); its capital structure is dictated by law and subject to the Commissioner's approval (*Id.* §21); the cooperative may not acquire real property, enter into any contract for construction or alteration of any real property, or sell any property, encumber or lease any real property, make any contracts for operation of the project, issue a guarantee of payment or enter into contracts for payment of salaries to officers or employees without the Commissioner's approval (*Id.* §§17, 27, 29). The Commissioner has the power to fix or to overrule the cooperative's rental structure (*Id.* §31(1)); to investigate all aspects of the affairs of the cooperative and its dealings with others (*Id.* §32); and, in the event that the cooperative violates any provision of

[7] At the time when the project in issue was conceived and developed, the "chairman" of the Agency and its "chief executive officer" was this very "commissioner of housing." Private Housing Finance Law §43(2). Although this provision was subsequently somewhat modified (N.Y. Laws, 1969, ch. 528, §3), the close relationship between the Commissioner and the Agency continued; the Commissioner remained a member of the Agency and could be named chairman. Private Housing Finance Law §42(2). Significantly, the Agency's ability "to make mortgage loans and to undertake commitments to make mortgage loans" was and still is expressly made "[s]ubject to the approval of the commissioner of housing." *Id.* §44(9). Apart from the Commissioner's absolute control of the Agency's ability to grant mortgage loans, he is by law "designated to act for and in behalf of the agency in servicing the mortgage loans . . . of the agency." *Id.* §55.

its certificate, or of law, or of the mortgage, or of any order of the Commissioner, the Commissioner has the power to remove all of the cooperative's directors and to replace them with his own designees (*Id.* §§13, 15(c)) and to commence an action in the Supreme Court of New York for the purpose of having such violations stopped or prevented (*Id.* §32(7), *as amended* (McKinney Supp. 1974)). Thus, from the initiation of a project and continuing thereafter "state control is pervasive." (UHF Brief p. 8).

In addition to the State, the Agency and the stockholders, there are three entities involved in Mitchell-Lama cooperative housing: a sponsoring organization, in this case, defendant UHF; a general contractor, in this case, defendant Community Services, Inc. ("CSI"); and a cooperative corporation, in this case, defendant Riverbay. The relationship between these three entities and their interlocking directors makes understandable the otherwise incredible chain of events which took place.

UHF is a corporation organized under the Membership Corporation Law (95a).[8] Its membership consists of trade unions and other organizations. CSI is a corporation organized under the Business Corporation Law and is a wholly-owned subsidiary of UHF (A9 ¶4, 67a ¶5, P-B3).[9] In the past and on this project, CSI was the "general contractor and sales agent for [UHF] sponsored projects"

[8] The reference at P-A4 to UHF's being incorporated under the New York Not-For-Profit Corporation Law is an obvious, but immaterial, error as the statute was not enacted until 1969, eighteen years after UHF was incorporated. N.Y. Laws, 1969, ch. 1066, eff. Sept. 1, 1970.

[9] As will be shown, this critical fact was not disclosed in the Information Bulletins.

(A11 ¶12, 67a-68a ¶5, 149a-150a, P-B3). Riverbay was organized by UHF, to own the land and buildings constituting the housing project and UHF designated its directors (A9-10 ¶¶5, 8-11, A32 ¶87, 73a ¶¶16-17), except for the one designated by the Commissioner (Private Housing Finance Law §13(7)). These directors were, for the most part, also officers, directors or both of CSI and UHF (A10 ¶¶8-11, 67a-68a ¶5). Defendant Ostroff, President and Director of Riverbay, is also President and Director of CSI and Executive Vice-President and Director of UHF (A10 ¶¶8-10, 65a ¶1).[10] For all purposes, Riverbay was under the control and domination of UHF and CSI, who grievously misused their power to plaintiffs' detriment (A32 ¶87, 153a).

The First "Information Bulletin" (Prospectus)

Just as with every other large-scale public offering, the sale of Riverbay stock was promoted by means of a prospectus, called in this instance an "Information Bulletin." Under date of May 12, 1965, the defendants began to distribute the first Information Bulletin to thousands of prospective purchasers by means of the mails (A22 ¶39, 159a *et seq.*). The Information Bulletin stated that the total estimated cost of the project was $283,696,550; that $32,795,550 of this amount (the venture or risk capital) was to be provided by stockholder-subscribers through the purchase of stock and/or other equity obligations; and that the balance was to be financed by means of a $250,900,000 forty-

[10] Mr. Ostroff's predecessor, the late Abraham Kazan, was president of all three corporations (179a, 213a, 344a).

year first mortgage loan to Riverbay from the Agency (A12 ¶17, 171a).

The Information Bulletin further stated that:

> "It is anticipated that the General Contractor for the construction of the project will be Community Services, Inc., of 465 Grand Street, New York 2, New York. The performance of certain sub-contracts to be made with the General Contractor will be insured by a surety company or companies in amounts to be approved by the Commissioner, in favor of the Housing Company [Riverbay], the General Contractor and the New York State Housing Finance Agency.
>
> • • •
>
> "The construction contract will be executed prior to the mortgage loan closing. *The contract will provide for the payment of a lump sum price to the Contractor for the construction of the project, in the amount of $258,678,000,* subject to addition or deduction for change orders during the progress of construction as approved by the Commissioner.
>
> "The contract price will include the sum of $2,000,000 for builder's home office overhead, but there will be no builder's fee. *The risk of completing the construction within the lump sum price is upon the Contractor.*" (A13-14 ¶18, 171a-72a) (emphasis added).

The Information Bulletin then stated that a copy of the construction contract was or would be made available for inspection by prospective purchasers and that they "should familiarize" themselves with it (A13 ¶18, 168a).

The construction contract referred to, between CSI and Riverbay, dated June 18, 1965, provided for payment of a lump sum fixed price of $258,507,750[11] for the construction of the project, including a flat fee of $2,000,000 for CSI's "Home Office Overhead" (A13-14 ¶19, 214a). With respect to all items of construction cost other than the item of Home Office Overhead, which items were specified in the schedule attached to the contract, the contract provided:

> "[T]he Contractor [CSI] guarantees payment for said items notwithstanding that the actual cost for said items may exceed the amounts therein set forth." (A13-14 ¶19, 202a).

Thus, the potential subscribers were guaranteed in the contract as in the Information Bulletin that no increases in construction costs would be passed on to them.

The Information Bulletin continued:

> "Subject to the approval of the Commissioner, Community Services, Inc., of 465 Grand Street, New York, New York, has been retained by the Housing Company as sole agent for the sale of stock and/or other equity obligations and apartments in the projects, at such fees as the Commissioner shall approve, not to exceed the amount shown in the schedule of the estimated project cost." (A14 ¶20, 175a).

The fee of $450,000 was shown in the schedule annexed to and made part of the construction contract (214a). The

[11] We can only surmise that the difference of $170,250, between this amount and the amount set forth in the Information Bulletin, *supra*, is attributable to the fact that the Information Bulletin preceded the execution of the contract and some small reduction was effected in the interval.

sales agency agreement between CSI and Riverbay, dated June 18, 1965, actually provided that the total amount to be paid to CSI would not exceed the sum of $450,000 (A14 ¶21, 318a-19a).

The Information Bulletin also represented that the average monthly carrying charge, required for operation and maintenance of the project and payment of the mortgage loan, would be approximately $23.02 per room (A14 ¶22, 174a. *See also* Private Housing Finance Law §§25, 26 (1)(b)).

The Material Omissions

The Information Bulletin however, failed to disclose the following material facts:[12]

1. The original lump sum price was not adhered to on any of the previous Mitchell-Lama housing projects sponsored by UHF and built by CSI (148a-49a).

2. All of the defendants knew from the outset that the project could not be completed for $283,695,550 (A17 ¶30, 149a-53a).

3. CSI was a wholly-owned subsidiary of UHF (67a-68a ¶5, 407a).

4. The net worth of CSI was incredibly small in comparison with the scope and cost of the project and thus CSI could not have been held to the lump sum contract price even if the sponsor or the Commissioner had so de-

[12] On appeal from a motion to dismiss the complaint, all allegations as to fraudulent statements and material omissions must be deemed true. *See, e.g.*, Walker Process Equip., Inc. v. Food Mach. & Chem. Corp., 382 U.S. 172, 174-75 (1965).

sired or if Riverbay had been free to act independently to enforce its own rights (149a-53a, pp. 15-16, *infra*).

5. In order to permit CSI to act as general contractor, although it only had 1/130 of the free liquid assets required by his own rules (151a-53a, 341a), the Commissioner simply waived the liquidity requirement (see pp. 15-16, *infra*).

6. There was another, but undisclosed, agreement between CSI and Riverbay, the administrative services agreement, which provided for payment to CSI of an additional $-00,000 (A16 ¶29, 329a *et seq.*).

The Commissioner's Waiver of His Own Liquidity Rule

Prior to the issuance of the Information Bulletin, the Commissioner had promulgated rules for the implementation of the Mitchell-Lama Act. Among those was a liquidity requirement for general contractors. That rule provided:

> "CONTRACTOR'S FINANCIAL PREQUALIFICATION REQUIREMENTS
>
> All GCs [General Contractors] submitting proposals for LPH [Limited Profit Housing] Companies shall have as free liquid assets $105,000 plus 5% of the amount of the contract in excess of $1,000,000, as set forth in the table below:

	Amount of Contract	Base	Base Amount	Above Base Amount Per $1,000
Above	$1,000,000	$1,000,000	$105,000	$50.00

> The determination of free liquid assets will be based on a financial statement of GC of recent date certified by a Certified Public Accountant." Guide for Development of Limited Profit Housing, Preliminary Submissions, Executive Department, State of New York Division of Housing and Community Renewal 35 (1971) (151a-52a).[13]

Applying that rule, the general contractor for Co-op City needed free liquid assets in excess of $13,000,000 in order to qualify.[14] By letter dated June 16, 1965, CSI forwarded to the Agency its *uncertified* financial statement as of December 31, 1964, showing "free liquid assets" of *less than $100,000* (341a *et seq.*). In the face of this startling inadequacy, the State casually endorsed in handwriting upon the face of the cover letter:

> "The financial statement and this letter supporting it has been requested as a matter of routine. In view of past performance of [General Contractor] and the technical setup of his operation, *the liquid asset prequalification has been waived in past and it is waived for this project also.*" (341a) (emphasis added).

The total net worth of CSI as shown in that same statement was only $201,872 (343a).

Bearing in mind that the Information Bulletin represented and the construction contract provided that CSI guaranteed completion of the construction for the lump sum price of $258,507,750, how could the Commissioner expect to hold CSI to that obligation, if it became impossible for it to perform at a profit or even at cost?[15] Since the

---

[13] We have been advised by the State that the above-quoted rule is substantially the same as the rule in effect in 1965.

[14] The cost of construction was contracted at $258,507,750 (214a).

[15] Even the sub-contractors' performance bonds, promised in the Information Bulletin (p. 11, *supra*), had been secretly waived (A18-19 ¶31(e)).

Commissioner knew that CSI had never lived up to its guarantee in the past, the necessary conclusion is that the Commissioner did not expect CSI so to perform (A17 ¶30, 148a-51a). The fact that the State had in addition waived its liquidity rule eradicated all margin of protection for Riverbay and, therefore, for plaintiffs.

In short, all of the economic safeguards so highly touted in the Information Bulletin either did not exist or were not worth the paper on which they were written.[16]

The Second "Information Bulletin" (Prospectus)

On or about May 15, 1967, defendants began to distribute a Revised Information Bulletin through the mails (A14 ¶23, 183a-200a). Since no change could have been made in the original bulletin without the Commissioner's "approval," this Revised Information Bulletin also bore the "imprimatur of the State" (P-B12). The Revised Information Bulletin substantially reiterated the statements with respect to financing, construction and sales made in the original Information Bulletin.[17] The Revised Information Bulletin, however, was as deficient as the original with respect to the above omissions.

[16] *See* People v. Cadplaz Sponsors, Inc., 69 Misc. 2d 417, 330 N.Y.S.2d 430 (Sup. Ct. 1972). It will be remembered that only persons of limited income were eligible to purchase Riverbay's stock (p. 6, *supra*) and that this public solicitation was directed at those people and not at a higher income group with greater investment experience. See also the dissenting opinion in Teherepnia v. Knight, 371 F.2d 274, 384 (7th Cir. 1967) and this Court's opinion in the same case, 389 U.S. 332, 345 (1967).

[17] The material differences were: (a) the total estimated development cost of the Co-op City project was $293,803,200, instead of $283,695,550 (A15 ¶25(a), 191a); (b) the venture or risk capital to be provided by stockholder-subscribers would be $32,803,200, instead of $32,795,550 (A15 ¶25(b), 191a); (c) the amount of the mortgage loan would be $261,000,000 instead of $250,900,000 (A15 ¶25(c), 191a); (d) the average monthly carrying charge would be approximately $25.00 per room, instead of $23.02 (A15 ¶25(d), 194(a); (e) the lump-sum construction contract price was $267,830,750, instead of $258,507,750 (A15 ¶25(e), 192a), and (f) the fee to be paid to CSI as sales agent would be $500,000, instead of $450,000 (A15 ¶25(f), 195a and 348a).

The Changes in the Construction Contract

Both the Information Bulletin and the Revised Information Bulletin advised prospective stockholders that they were further protected from any improper costs being foisted upon them because:

> "The Commissioner must also approve all contracts executed by the Cooperative for the construction and operation of the development and is charged by law with the responsibility of keeping informed as to the general condition of the development, its capitalization and the manner in which the development is constructed, leased, operated and managed." (189a).

1. *The First Increase of $9,328,000*

Pursuant to his "responsibility" to plaintiffs, on April 14, 1967, the Commissioner approved the first increase in the building contract between UHF's wholly-owned subsidiary, CSI, and their captive, Riverbay, because of "an increase in the cost of construction" the very contingency from which plaintiffs were to be protected (A15-16, A17-18, ¶31, 215a-20a). The Revised Information Bulletin omitted any reference to the fact that the Commissioner had permitted a change in the "lump-sum price" contract, and

merely used the increased figure as if it were the original figure (192a), without even informing the existing purchasers of the retroactive increase.

2. *The Second Increase of $250,000*

On January 22, 1968, by agreement between CSI and Riverbay, again with the approval of the Commissioner, the lump-sum construction contract price was increased from $267,830,750 to $268,080,750, an increase of $250,000 and an aggregate increase of $9,578,000 from the original contract price (A17 ¶31(a), 221a-24a). This entire increase was for the express purpose of giving CSI an additional "fee" of $250,000 and was a complete violation of a limit contained in Article 12 of the contract itself confining any increase in CSI's fee to 1% of the dollar value of any change order (208a).

3. *The Third Increase of $1,900,000*

On March 29, 1968, by agreement between CSI and Riverbay, with the approval of the Commissioner, the lump-sum construction contract price was increased a third time, because of "an increase in the cost of construction" from $268,080,750 to $269,980,750, an increase of $1,900,000 and an aggregate increase of $11,478,000 from the original contract price (A17-18 ¶31(b), 225a-26a).

4. *The Fourth Increase of $40,519,250*

On October 9, 1969, by agreement between CSI and Riverbay, the lump-sum construction contract price was increased the fourth time, with the Commissioner's approval, because of "a further increase in the cost of construction" from $269,980,750 to $310,500,000, an increase of $40,519,250 (including a $500,000 increase in CSI's "overhead" fee, and an

aggregate increase of $51,997,250 from the original contract price (A18 ¶31(c), 229a-36a).

5. *The Fifth Increase of $30,000,000*

On July 7, 1971, by agreement between CSI and Riverbay, again approved by the Commissioner, the lump-sum construction contract price was increased the fifth time, because of "a further increase in the cost of construction" from $310,500,000 to $340,500,000, an increase of $30,000,000 (including another increase of $300,000 in CSI's fee) and an aggregate increase of $81,997,250 from the original contract price of $258,507,750 (A18 ¶31(d), 237a-43a).

In each instance, the increases were made with the consent and approval of the Commissioner, but without any notice to the existing subscribers to Riverbay's stock[18]

---

[18] Defendants claim that plaintiffs "were advised of the increases in costs and carrying charges" (CHF Brief p. 9). The record reference is to a form letter allegedly circulated in 1968. While the question of a subsequent disclosure is irrelevant in determining whether Riverbay stock is a security, it must be noted that the receipt of that letter is denied (370a). Moreover, even if such a form letter was sent it would not amount to disclosure but to a further concealment of the material facts. The letter purportedly advised the subscribers that increases in four types of costs *might* result in an increase of an unspecified amount in the 1970-71 carrying charges. Two of these types of costs, operating costs and real estate taxes, are not material to the issues presented. The statement as to interest charges indicates that financing costs were running 1.2% over estimates but "declining slightly." As to construction costs, the letter recites that there will be "some construction cost increases" due to "escalations in regard to labor costs . . . unforeseen conditions . . . [and] inflationary pressures" (101a). It is impossible to read this letter and not conclude, as defendants apparently intended that the increases in construction costs from higher wages and inflationary pressures were the risk of Riverbay. Yet the construction contract between Riverbay and CSI placed on CSI, not Riverbay, the risk of loss in these areas (202a). Defendants have never claimed that the increased costs were due to "unforeseen conditions." Finally although defendants had amended that contract three times by October, 1968, increasing the cost of

(A17-19 ¶31, 18, 369a). Nor was any correction to reflect those increases made in the Revised Information Bulletin, which continued to be distributed in its unaltered form.[19] These increases in construction costs were, according to defendants, caused by "inflation" (76a ¶20, 377a). These increases were all passed on to Riverbay (171a-72a, 192a, 208a), although the Information Bulletins clearly represented and the construction contract expressly required that any such inflationary costs be absorbed by CSI. *See* pp. 11-12, *supra*.

6. *Increase of Service Fees by $2,510,000*

Because of and in addition to the increase in the price of the construction contract, the costs of related service fees were likewise increased by $2,510,000 without the knowledge or consent of plaintiffs.[20] Not one of these changes, also approved by the Commissioner, found its way into a writing sent to plaintiffs.

---

construction by $11,470,000, they did not see fit to disclose that fact in the letter.

[19] The District and Circuits Courts' references to further "revised estimates" (P-B11, P-A7) are erroneous insofar as they suggest that such revisions were included in a subsequent Information Bulletin.

[20] (a) Architect's fees increased from $2,350,000 in the original Information Bulletin (169a) to $2,550,000 in the Revised Information Bulletin (190a), and thereafter, to $2,975,000 (A19 ¶32a, 353a); (b) engineer's and laboratory fees increased from $750,000 in the original schedule (347a) to $1,275,000 (A19 ¶32(b), 353a); (c) surveyor's fees increased from $400,000 in the original schedule (347a) to $1,450,000 (A19 ¶32(c), 353a); (d) legal fees increased from $150,000 in the original schedule (347a) to $270,000 (A19 ¶32(d), 353a); (e) selling expenses (payable to CSI) increased from $450,000 (347a) to $600,000 (A19 ¶32(e), 353a); (f) administrative expenses (payable to CSI) increased from $200,000 (347a) to $300,000 (A20 ¶32(f), 353a).

Increases in the Mortgage

In order to pay for the increases, defendants caused Riverbay to enter into several modification agreements with the Agency, again without the knowledge or consent of plaintiffs, successively increasing the original mortgage loan to Riverbay by amounts sufficient to cover the increases in construction costs and related services, as well as further increases in financing costs resulting therefrom (A20 ¶33, 376a-77a). In approving and granting the increases in the mortgage loan, the Commissioner and the Agency participated in and abetted the other defendants' repudiation of the representations contained in the Information Bulletins and the breach of their fiduciary obligations to Riverbay and to plaintiffs, and caused Riverbay to exceed its authority to borrow, as defined by the subscription agreements with plaintiffs (A20 ¶33).

Thus, the mortgage loan was increased in four stages, from $236,655,710 to $375,755,710[21] (A20 ¶34, 258a-315a), to pay for the increases set forth above and also for increases of $1,670,000 in the fees of the State and the Agency, as well as increased interest of $64,750,000.[22]

The Resulting Increases in Carrying Charges

In order to repay the increased mortgage loan, defendants, with the Commissioner's approval, caused Riverbay to increase plaintiffs' average monthly carrying charge

---

[21] This figure excludes $46,000,000 which was added to finance construction of schools, a matter not presently in issue (371a).

[22] (a) Supervising fees (New York State Department of Housing and Community Renewal) increased from $2,509,000 to $3,510,000 (A20 ¶34a, 347a-61a); (b) Agency fees increased from $501,800

from an estimated $23.02 per room in 1965, to $25.00 in 1967, to $29.39 from July 1, 1970 through December 31, 1972, to $35.27 from January 1, 1973 through June 30, 1974, to $39.68 commencing July 1, 1974, all without plaintiffs' consent (A21 ¶35, 362a-64a, 372a-73a, P-B11).[23]

Throughout the period when these changes were taking place, defendants were soliciting "offers for shares of . . . [Riverbay's] capital stock" (A14-15 ¶¶23-24, A16 ¶28, 183a-202a) on the basis of Information Bulletins *which omitted every single one of these salient facts.* In other words, plaintiffs bought Riverbay stock for cash down-payments totaling $32,803,200, *inter alia,* to obtain housing at a cost of $23.02 and then $25.00 per room per month, whereas the actual but undisclosed charge was to be at least $39.68 per room per month and undoubtedly even more in the future. Defendants never disclosed any of these material changes to the plaintiffs who had already purchased stock and given up rent-controlled apartments on the basis of the original Information Bulletin (A17-20 ¶¶31-34, 368a *et seq.*, P-B12).

The Securities Sold Pursuant to the Information Bulletins

Contrary to defendants' claim that plaintiffs were merely offered an apartment (UHF Brief p. 26), it is clear that plaintiffs were invited to and did purchase common stock.

---

to $1,170,000 (A20 ¶34(b), 347a-61a); (c) title and recording expenses increased from $340,000 to $545,000 (A20 ¶34(c), 347a-61a); (d) interest, capitalized for the construction period, increased from $6,250,000 to $71,000,000 (A20 ¶34(d), 347a-61a).

[23] Some portion of the latest increases may be attributable to increased costs of operation and maintenance.

The Information Bulletin and the Revised Information Bulletin:

> "[I]nvite[d] offers for shares of [Riverbay's] capital stock and/or other equity obligations for sale in units which will be allocated to the 15,500 [revised to 15,372] apartments of the development all in accordance with the terms of the subscription agreement." (A14-15 ¶¶23-24, A16 ¶28, 178a, 196a).

The subscription agreement commenced:

> "RIVERBAY CORPORATION
>
> Subscription Agreement and Apartment Application
>
> (Limited to Residents of the State of New York)
>
> (1) I, (we) ....., hereinafter individually and collectively called the "Subscriber", hereby subscribe at the par value and principal amount thereof, to an aggregate of:
>
> [A specified dollar amount depending upon type of apartment chosen]
>
> par value of Class B capital stock of Riverbay Corporation, . . . for the purpose of acquiring land and constructing and operating a housing project . . . ." (104a).

The True Purchase Price of Riverbay Stock Was Never Disclosed to Plaintiffs

Each subscriber agreed to purchase 18 shares of Riverbay stock, at $25 par value per share, for each room in the apartment selected, for a cash payment of $450 per

room (89a, 172a-73a, 193a). Although nowhere revealed in the Information Bulletins, this sum was not the total purchase price but only a down-payment amounting to less than 12 per cent of that price.[24] The true price had been fixed by agreement of the defendants at $3,856 per room (347a). The difference between the down-payment and the total price was financed by the Agency through its mortgage loan to Riverbay. The amortization and interest expense of that mortgage loan was passed on to plaintiffs by Riverbay as part of the monthly carrying charges. Thus, when all the contract changes discussed above had taken place and the mortgage loan had been repeatedly increased to cover those changes and related increases, the total cost of the project rose from $283,695,550 to $418,203,982 (*compare* 171a *with* 353a). The net effect of the defendants' actions was to raise the purchase price of Riverbay stock from $3,856 to $5,737 per room (*compare* 347a *with* 353a). The actual purchase price of plaintiffs' stock was more than 11.7 times the represented price. Needless to say, this feat was accomplished by defendants without even notifying plaintiffs, much less obtaining their consent.[25]

It will be remembered that to be eligible for a four room apartment a family of two was permitted a maximum annual gross income of $6,624. The cost of Riverbay stock to that family leaped from $15,424 to $22,948. The fact that, for eligibility purposes, their maximum permissible income would increase in direct proportion to the escalating cost of Riverbay stock was of small comfort to those plaintiffs on fixed retirement incomes who had already made their purchase and taken occupancy in reliance upon the representations in the Information Bulletins.

[24] The Information Bulletins and the stock subscription agreement described the $450 per room price as the "total equity requirement" (105a, 173a). This misstatement is perpetuated in defendants' brief (UHF Brief p. 12).

[25] Despite having grossly misstated the purchase price of plaintiffs' stock and then secretly increasing it to cover the cost of their self-dealing in violation of all their representations and contracts, defendants now unblushingly claim that plaintiffs obtained an "outstanding bargain" (UHF Brief p. 9 n.8). Even if true, the claim, which is not based on any facts in the record, would scarcely excuse defendants' fraudulent conduct.

The Economic Inducements Contained in the Information Bulletins

Just as with any securities offering, there were economic inducements to the investors. The Court of Appeals found that there were substantial economic inducements to potential purchasers in this huge offering, in the form of (a) income to be derived from commercial tenants and realized by plaintiffs through reduced carrying charges; (b) savings in federal and State personal income taxes resulting from the right to deduct a pro rata share of interest and real estate taxes paid by Riverbay; and (c) savings of the difference between the cost of living in Co-op City (at the represented rates) and the "going rate" for comparable housing (P-A15-18).

Defendants assert flatly, "The Co-op City Information Bulletins contain no representation with respect to potential profit or income" (UHF Brief p. 26). That statement is plainly contradicted by the record. The Information Bulletin states:

> "If there should be a surplus of income over expenses at the end of the year, the Board of Directors, after

providing for adequate reserves, may return this surplus, or part of it, to the cooperators in the form of a rent rebate[26] (162a).

• • •

"The Advantages of
Cooperative Housing

"People find living in a cooperative community enjoyable for more than one reason. Most people join, however, for the simple reason that it is a way to obtain decent housing at a reasonable price (166a).

• • •

"In many cooperatives the self-help method which made the housing possible is extended to meet the needs of consumers in other fields. It is not uncommon for cooperators to organize cooperative foodmarkets, credit unions, nursery schools, insurance plans, health plans, —all designed to benefit themselves (169a).

• • •

"All of the apartments as well as the community facilities will be centrally air conditioned. This will be possible because Co-op City will operate its own power plant. The plant will provide the community with its own electric power, hot water, heat and air conditioning.

"The project will contain parking facilities to accommodate 10,850 automobiles which will be provided for rental to tenant-cooperators at $17.50 per month (175a).

• • •

[26] This is the "dividend" referred to by the Court of Appeals at P-A16.

"Tax Benefits (*Id.*)

• • •

"The present laws and regulations entitle tenant-stockholders of cooperative housing corporations to deduct from their gross income for Federal and New York State income tax purposes their proportionate share of real estate taxes and interest paid by such cooperative corporations. The actual tax saving to an individual would depend upon the respective taxpayer's income tax bracket." (*Id.*).

It cannot be seriously urged that plaintiffs, all people of limited means, willingly invested what for many was their life savings without any hope of financial gain. Defendants appear to contend that plaintiffs paid out $32,803,200 in hard cash merely to further defendants' cooperative effort. Plaintiffs, however, made their purchases for the total package which defendants offered: stock ownership in a giant cooperative real estate enterprise, tax deductions, the possibility of dividend income, and decent living accommodations at a real dollar saving. Defendants' attempt to deprive plaintiffs of the protection of the federal securities laws by artificial formal distinctions between kinds of economic inducements was properly rejected by the Court of Appeals.

The Incidents of Ownership of Riverbay Stock

Defendants have repeatedly argued that there are certain unique conditions attached to Riverbay's common stock which somehow justify depriving plaintiffs of protection under the antifraud provisions of the federal securities laws. The argument is refuted by an examination of the

stock itself.[27] 15,372 stockholders have purchased 1,312,128 shares of Riverbay common stock[28] (A7 ¶2(b)). Each share has a par value of $25, for a total par value of $32,803,200, which has actually been paid in by plaintiffs and spent by Riverbay for construction (A23 ¶44). Had Riverbay gone bankrupt, plaintiffs would have lost most if not all of their investment (P-A18). It was therefore risk capital in every sense of the term. *See* pp. 54-57, *infra*.

The stockholders have the customary right to elect directors and vote on those other matters which normally are reserved to stockholders.[29] Each stockholder has the right to take income tax deductions for a portion of his monthly carrying charges (175a, 195a, 396a-98a). He has the right to enter into an occupancy agreement for an apartment[30] (105a, 108a-19a). His shares, upon his death, pass to his spouse (135a).

---

[27] In an effort to becloud the fact that plaintiffs are stockholders, defendants persist in referring to them as "members" and to their shares as "memberships" (UHF Brief pp. 7, 10 *et seq.*). Of course even if only "memberships" were involved, a security would nevertheless be present. *See, e.g.*, Davenport v. United States, 260 F.2d 591 (9th Cir. 1958), *cert. denied*, 359 U.S. 909 (1959); Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811. 361 P.2d 690 (1961).

[28] The plaintiffs will not actually receive their stock certificates until the Commissioner certifies that the project has been completed and paid for (171a, 191a). The Court of Appeals correctly held that this factor in no way affects plaintiffs' claims asserted herein (P-A9).

[29] The By-Laws provide for one vote per apartment, rather than one vote per share, which the Court of Appeals found had "little, if any, functional difference" in view of the fact there are 1,312,128 shares of stock with no stockholder owning more than 126 of those shares or .0096% (P-A10 n.8, 89a).

[30] The subscription agreement is also an application for an "occupancy agreement . . . for a term of not more than three years, which shall be automatically renewable, unless terminated at the end of any three-year term by [Riverbay] or the tenant-cooperator" (105a).

Riverbay leases commercial and office space to tenants (not stockholders) and operates parking and washing machine facilities. The millions of dollars of rental income from Riverbay's business activities are available for payment of its general expenses, thereby reducing the amount of carrying charge income required from the plaintiffs (P-A16). By law, after all costs and expenses are paid, Riverbay must pay any surplus to the plaintiffs in the form of a dividend. Private Housing Finance Law §28.[31] Similarly, in the event of a dissolution, upon the repayment of all outstanding indebtedness, all remaining assets are required to be distributed to the stockholders. *Id.* § 35(3). Yet, notwithstanding all of those attributes, defendants baldly assert that this stock "has no independent significance or meaning" (UHF Brief p. 12).

The only restriction on the ownership of Riverbay stock worthy of mention is the provision in Riverbay's By-Laws that when a stockholder seeks to sell his stock, Riverbay has the right of first refusal at a price equal to the purchase price (131a-32a). The Court of Appeals correctly recognized that this was in no sense a unique provision (P-A11). Many corporations have similar provisions in their By-Laws or in stockholder agreements.[32] Moreover, in the event that Riverbay is unwilling or unable to exercise its right of first refusal, the stockholder is free to sell to anyone acceptable to Riverbay and to the Commissioner (132a-33a). The selling price in such a sale is not limited by

---

[31] Defendants' assertion that there is no "possibility of dividends" (UHF Brief p. 12) is thus contradicted by statute, as well as by their own Information Bulletins which speak of a "rent rebate" out of surplus (162a).

[32] *See, e.g.* Allen v. Biltmore Tissue Corp., 2 N.Y.2d 534, 141 N.E.2d 812 (1957).

Riverbay's By-Laws at all.[33] Further, if there should be a default and forfeiture of the stockholder's interest, Riverbay is free to sell the stock "at public or private sale" (134a-35a). Any profit after payment of all indebtedness to Riverbay is to be turned over to the stockholder, who is also liable for any deficiency (*Id.*). Thus, there is even the "possibility of . . . appreciation in value," the very touchstone of defendants' argument (UHF Brief p. 11 *et seq.*). However, as will be shown, the possibility of appreciation in value is not a condition precedent to the application of the federal securities laws.

The "Profitability" of the Transaction From the Seller's Viewpoint

While it would seem to make little difference to a defrauded buyer whether or not the seller was motivated by an eleemosynary purpose or was an admi[illegible]vindler (P-A18), defendants insistently urge that thi[illegible] non-profit transaction from their point of view (UHF Brief p. 5). To lay this pretext to rest, once and for all, we enumerate some of the elements of profit to the defendants inherent in this "non-profit" transaction.

1. CSI, the general contractor, is a corporation organized for profit (A9 ¶4, 67a ¶5) and a wholly-owned subsidiary of UHF. The construction contract, after amendment, provided for payment by Riverbay to CSI of a $2,250,000 builders fee, which was included in the project cost (221a-

[33] In 1971, after the transactions in issue, the New York Legislature enacted Section 31a of the Private Housing Finance Law, which set the maximum resale price at the purchase price plus a pro-rata share of the amortization of the mortgage. N.Y. Laws, 1971, ch. 1148.

24a). In addition, also after amendment, CSI was to receive $600,000 in sales commissions (353a) and $300,000 for administrative services (353a). Thus, CSI reaped $3,150,000 as its share.

2. UHF, in addition to the benefits derived by virtue of being CSI's parent (a fact not disclosed in the Information Bulletins), also benefited in its own right. It solicited from plaintiffs "voluntary" loans of $10 per rental room payable at the time of apartment selection (166a, 187a). These loans were to bear interest at the token rate of 2 per cent. There are 72,896 rental rooms in Co-op City, resulting in a total loan of $728,896 to UHF at 2 per cent interest (348a).[34]

3. The State was paid $3,510,000 as its supervisory fee (353a). As the cost of the project went up, so did the State's fee.

4. The Agency was paid $1,170,000 as its financing fee (356a). Similarly, its fee increased as Riverbay's mortgage loan increased.

5. Defendants Szold, Altman and Alter are partners in the law firm of Szold, Brandwein, Meyers and Altman, attorneys for Riverbay (175a). Their firm was paid $210,000 in legal fees for this project (353a), and continues as its counsel.

6. Herman J. Jessor, the architect, was ultimately paid $2,975,000 for preparing the plans and specifications for

[34] The record is silent as to how many residents of Co-op City, if any, refused to make this "voluntary" loan.

the project (A19 ¶32(a), 353a). Mr. Jessor's address is stated in the Information Bulletins to be 465 Grand Street, New York, New York, coincidentally, the very same address given for UHF and CSI (167a, 188a).

7. In addition to the foregoing, there are the more subtle profits flowing to defendants from this kind of undertaking. For example, as alleged in the eighth count of the amended complaint, certain stores in Co-op City were knowingly leased for $500,000 less than their fair rental value (A31). It is not unreasonable to infer that these favored leases were given in consideration for extrinsic benefits received by defendants.

Ultimately, even the absence of personal profit motive on the part of defendants would not, in the words of the Court of Appeals,

> "eliminate the incentive for fraudulent or deceptive practices in the sale of cooperative stock. Whether it were to recoup advances already made or to retain a particular reputation even a nonprofit entity may encounter pressures which might have the tendency to change an otherwise objective and fair sales pitch to something likely to entice and mislead." (P-A18).

Summary of Argument

The United States District Court has subject matter jurisdiction because plaintiffs' amended complaint alleges that they were defrauded in the purchase of a security as comprehended by the antifraud provisions of the federal securities laws. The common stock of Riverbay Corporation is a security because it qualifies as either (1) "stock,"

or (2) an "investment contract," or (3) "any instrument commonly known as a 'security.'"

The defense of immunity under the Eleventh Amendment is not applicable to the Agency, which is not the *alter ego* of the State. Nor is this defense available to the State. It has been expressly waived by the New York State Legislature's enactment of Section 32(5) of the State's Private Housing Finance Law. It has also been waived by the State's embarkation upon a statutory housing plan designed to fulfill a State need with private funds, in which the State is directly involved in the public solicitation of venture capital by use of the mails and where State control over every aspect of planning, public solicitation of stock, construction and financing is pervasive.

ARGUMENT

POINT I

The common stock of Riverbay purchased by plaintiffs is a security within the meaning of the federal securities laws.

A. The common stock of Riverbay is within the meaning of the term "stock" in the statutory definition of a security.

Section 3(a)(10) of the 1934 Act provides in pertinent part:

> "The term 'security' means any . . . stock."[35] 15 U.S.C. §78c(a)(10).

---

[35] The statute is quoted in full at p. 3 of the Appendix to the UHF Brief. Almost the identical definition appears in Section 2(1) of the 1933 Act, 15 U.S.C. §77b(1). The statutes are treated *in pari materia*. Teherepnin v. Knight, 389 U.S. 332, 335-36 (1967).

The plain meaning of the statutory language, the relevant case law, legislative history, the Rules and Regulations of the Securities and Exchange Commission ("SEC"), the corresponding State blue sky laws and virtually all of the legal commentators are in accord that the statutory term "any . . . stock" means all stock, and in any event, would certainly include the stock of Riverbay Corporation.[36]

1. *The Statutory Language*

As this Court has frequently stated:

> "There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes." *United States* v. *American Trucking Associations, Inc.*, 310 U.S. 534, 543 (1940).

See also Addison v. *Holly Hill Fruit Products, Inc.*, 322 U.S. 607, 617-18 (1944); *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, 355 (1943); *Browder* v. *United States*, 321 U.S. 335, 338 (1941).

The word "any" means "one indiscriminately of *whatever kind* or quantity." *Federal Deposit Insurance Corp.* v. *Winton*, 131 F.2d 780, 782 (6th Cir. 1942) (emphasis added). "Stock" is "incorporeal personal property representing a capital interest in a corporation." *Stockton* v. *Lucas*, 482 F.2d 979 (Temp. Emer. Ct. App. 1973). Clearly, the common stock of Riverbay qualifies under the express language of the statute. *1030 Tenants Corp.* v. *Jakobson*, 503 F.2d 1375 (2d Cir. 1974). *See also* cases cited at p. 41, *infra*.

---

[36] Ohio takes no position on the Second Circuit's holding that Riverbay stock is a security (Ohio Brief p. 2). New York merely adopts the UHF presentation (N.Y. Brief p. 2).

Moreover, even if the stock in issue lacked any single incident common to most stock, this would not alter its status. *See Tcherepnin* v. *Knight*, 389 U.S. 332 (1967). This Court has frequently instructed the lower courts to construe the federal securities laws "not technically and restrictively, but flexibly to effectuate [their] remedial purposes." *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151 (1972); *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971); *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963). This fundamental principle underlies all of the case law on the subject.

2. *The Case Law*

On at least two occasions, this Court has carefully explained the sections of the statutes which define the term "security"—in *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344 (1943) and in *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967). In *Joiner*, the seminal case, the Court stated:

> "In the Securities Act the term 'security' was defined to include by name or description many documents in which there is common trading for speculation or investment. *Some, such as notes, bonds, and stocks, are pretty much standardized and the name alone carries well settled meaning.* Others are of more variable character and were necessarily designated by more descriptive terms, such as 'transferable share,' 'investment contract,' and 'in general any interest or instrument commonly known as a security.' We cannot read out of the statute these general descriptive designations merely because more specific ones have been used to reach some kinds of documents. *Instruments*

> *may be included within any of these definitions, as matter of law, if on their face they answer to the name or description.* However, the reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts,' or as 'any interest or instrument commonly known as a "security."'" 320 U.S. at 351 (emphasis added).

"Matter of law" is defined as "whatever is to be ascertained or decided by the application of statutory rules or the principles and determination of the law *as distinguished from the investigation of particular facts.*" Black's Law Dictionary, 1130-31 (rev. 4th ed. 1968) (emphasis added).

In applying its interpretation of the statutory definition, the Court observed:

> "In the present case we do nothing to the words of the Act, we merely accept them. It would be necessary in any case for any kind of relief to prove that documents being sold were securities under the Act. In some cases it might be done by proving the document itself, *which on its face would be a note, a bond or a share of stock. In others proof must go outside of the instrument itself as we do here.*" 320 U.S. at 355 (emphasis added).

This language compels the conclusion that if an instrument is a share of stock "on its face," it is within the scope of the statutes. As defendants concede, "Co-op City's cooperative

members subscribe to instruments *formally denominated 'stock'*" (UHF Brief p. 11) (emphasis added).

Moreover, the Court pointed out:

> "In the enforcement of an act such as this it is not inappropriate that promoters' offerings be judged as being what they were represented to be." 320 U.S. at 353.

This observation applies directly to the present case, where the Information Bulletins specifically "invite[d] offers for shares of [Riverbay's] capital stock" (178a, 196a). Even assuming *arguendo* that Riverbay's stock was not otherwise within the statutory definition, in view of this Court's ruling it would nevertheless be included because defendants represented it as such to the plaintiffs (see P-A12-13).

The *Joiner* rule was quoted and reaffirmed by this Court in *Tcherepnin* v. *Knight*, 389 U.S. 332, 339 (1967). On its facts *Tcherepnin* bears a striking resemblance to the instant case. The plaintiffs there were purchasers of withdrawable capital shares of an Illinois savings and loan association.[37] They brought a class action under Section 10(b) of the 1934 Act and Rule 10b-5 seeking equitable relief. The defendants claimed that these withdrawable capital shares were neither stock nor investment contracts. In support of their argument they urged, as do defendants herein, that the shares represented memberships, not investments (389 U.S. at 336); that the shares were not negotiable and only quali-

---

[37] These shares were "securities" under Illinois law, Teherepnin v. Knight, 371 F.2d 374, 383 (7th Cir. 1967) (dissenting opinion), just as Riverbay shares are securities under New York law. See N.Y. Gen. Bus. Law §352-e (McKinney 1968, Supp. 1974); People v. Cadplaz Sponsors, Inc., 69 Misc. 2d 417, 330 N.Y.S.2d 430 (Sup. Ct. 1972).

fiedly assignable (*Id.* at 337, 340); and that the shareholders had neither pre-emptive rights nor the right to inspect corporate books and records (*Id.* at 343). Moreover, although not discussed *in haec verba*, it is evident from a reading of the opinions of this Court and the Court of Appeals (371 F.2d 374 (7th Cir. 1967)) that the two principal arguments advanced by the defendants herein were also advanced in *Tcherepnin*, namely: (1) that the corporation involved was closely regulated by the State (defendants Knight and Hulman were State officials charged with supervision of the affairs of the issuer), and (2) that there was no element of capital appreciation attaching to the shares.[38]

This Court declined to bar access to the federal forum on the basis of factors which, although not common to all securities, "serve only to distinguish among different types of securities" (389 U.S. at 344). Terming the alleged absence of fluctuation in value and active trading on an exchange or over the counter "irrelevant . . . to the threshold question of whether a federal court has jurisdiction over the compiaint" (*Id.* at 345, 346), the Court had "little difficulty" in holding the shares includible as "stock"[39] under Section 3(a)(10) of the 1934 Act because of two factors: (1) the existence of a stock certificate and (2) the payment of dividends. 389 U.S. at 338, 339. Both of these factors are unquestionably present in this case, although the dividends may take the form of a reduction in carrying charges.

The policy considerations present in *Tcherepnin* are also present here. Ultimately, as a matter of policy, the Court

[38] The shares in *Tcherepnin* were redeemable at par and the plaintiffs' financial return was to come from dividends out of profits, if any. 389 U.S. at 338-39.

[39] This Court also held that the shares were includible as investment contracts. 389 U.S. at 339.

decided to extend "the investor protections afforded by the Securities Exchange Act" to the many small investors—like the plaintiffs in *Tcherepnin* and plaintiffs here—even "'less able to protect themselves than the purchasers of orange groves in *Howey*.'" *Id.* at 345.

This Court's decision in *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972), also compels the conclusion that the stock involved in the instant case is a "security." The Ute Partition Act, 25 U.S.C. §677 *et seq.*, provided for a distribution of the assets of the Ute Indian tribe. A corporation, UDC, was formed for the purpose of managing all assets not susceptible of practical distribution. Ten shares of UDC stock were issued to each member of the tribe. All of the shares were physically delivered to the Bank of Utah, as transfer agent, and the bank then delivered its receipt for ten shares to each tribe member.

The shares were subject to several restrictions. First, the Ute tribe was to have the right of first refusal in the event that a member wished to sell his shares. If the tribe rejected the offer, a member could sell to a non-member but only at a price no lower than that offered to the tribe. Secondly, the UDC certificates stated that they did not represent ordinary corporate stock.

Among the litigation generated by the UDC plan was the so-called *Reyos* case, 406 U.S. at 144-54, in which a number of shareholders instituted suit under Rule 10b-5 against the Bank, its employees, and the United States. In finding that the defendants' conduct violated Rule 10b-5, this Court held that the certificates were "securities," despite the facts that the shares expressly stated that they were not ordinary corporate stock, had been issued as an

incident of tribal membership, and were subject to stringent restrictions. 406 U.S. at 152.

This so-called literal approach, based simply upon the language that Congress chose to utilize in the statute, has been consistently followed in the lower courts. *See, e.g., 1050 Tenants Corp.* v. *Jakobson*, 503 F.2d 1375, 1378 (2d Cir. 1974); *Lehigh Valley Trust Co.* v. *Central National Bank of Jacksonville*, 409 F.2d 989, 991-92 (5th Cir. 1969); *Llanos* v. *United States*, 206 F.2d 852, 854 (9th Cir. 1953), *cert. denied*, 346 U.S. 923 (1954); *Movielab, Inc.* v. *Berkey Photo, Inc.*, 321 F. Supp. 806, 809 (S.D.N.Y. 1970), *aff'd per curiam*, 452 F.2d 662 (2d Cir. 1971); *Prentice* v. *Hsu*, 280 F. Supp. 384, 386 (S.D.N.Y. 1968); *Olympic Capital Corp.* v. *Newman*, 276 F. Supp. 646, 653 (C.D. Cal. 1967); *Whitlow & Associates, Ltd.* v. *Intermountain Brokers, Inc.*, 252 F. Supp. 943, 947-48 (D. Hawaii 1966); *SEC* v. *Gulf Intercontinental Finance Corp.*, 223 F. Supp. 987, 994 (S.D. Fla. 1963); *SEC* v. *Addison*, 194 F. Supp. 709, 721 (N.D. Tex. 1961).[40]

---

[40] Our research has disclosed no decision other than that of the District Court in this case in which a federal court has refused to treat as a security an instrument denominated as a share of stock. With respect to "notes," however, there is some conflict. Some courts have declined to characterize as "securities" notes given in personal loan or consumer credit transactions. *See, e.g.*, C. N. S. Enterprises, Inc. v. G. & G. Enterprises, Inc., CCH Fed. Sec. L. Rep. ¶94,938 (7th Cir. Jan. 13, 1975) (loan to purchase assets of small business enterprise); McClure v. First National Bank, 497 F.2d 490 (5th Cir. 1974) (commercial loan); Bellah v. First National Bank, 495 F.2d 1109 (5th Cir. 1974) (commercial loan); Lino v. City Investing Co., 487 F.2d 689 (3d Cir. 1973) (sale of franchise licensing agreement). In these transactions, of course, unlike transactions involving stock, there was neither a public offering nor even a purchase and sale as commonly understood. In SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943), this Court held that the statutes would apply if the "novel, uncommon or irregular devices . . . were widely offered," as were the Riverbay shares. Whatever the soundness of the rationale for excluding certain notes from the purview of the statutes, it clearly has no application here.

Moreover, every decision considering the application of the federal securities laws to cooperative stock has held in accord with the decision of the Court of Appeals below. *See, e.g., 1050 Tenants Corp.* v. *Jakobson*, 503 F.2d 1375 (2d Cir. 1974); *Grenader* v. *Spitz*, CCH Fed. Sec. L. Rep. ¶95,008 (S.D.N.Y., Mar. 5, 1975); *Ashton* v. *Thornton Realty Co.*, 346 F. Supp. 1294 (S.D.N.Y. 1972), *aff'd*, 471 F.2d 647 (2d Cir. 1973); *cf. Stockton* v. *Lucas*, 482 F.2d 979 (Temp. Emer. Ct. App. 1973); *Davenport* v. *United States*, 260 F.2d 591 (9th Cir. 1958), *cert. denied*, 359 U.S. 909 (1959); *U of F Students Cooperative*, [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶78,347 (S.E.C. 1971).

In this case, however, the Court need not determine whether every conceivable share of common stock is covered by Section 3(a)(10) of the 1934 Act (or the parallel provision of the 1933 Act). The Court need only determine that the public solicitation of offers for 1,312,128 shares of Riverbay common stock through the mails and the sale of those shares to 15,372 purchasers for a $32,803,200 cash down-payment falls within the purview of the statutes. *See Movielab, Inc.* v. *Berkey Photo, Inc.*, 452 F.2d 662, 663 (2d Cir. 1971); p. 40, n.40, *supra*.

3. *The Legislative History*

The primary intention of Congress in enacting the federal securities laws was to reach all securities[41] other than those

---

[41] *See* H.R. Rep. No. 85, 73d Cong., 1st Sess. 6-7, 11 (1933); S. Rep. No. 47, 73d Cong., 1st Sess. 1 (1933); S. Rep. No. 792, 73d Cong., 2d Sess. 14 (1934).

In conformity with the congressional purpose, the courts have interpreted the statute to reach many varied and unusual types of arrangement. *See, e.g.*, Affiliated Ute Citizens v. United States,

specifically excluded or exempted.[42] This intention is established beyond question by Congress' express determination to cover all securities subject to the existing blue sky laws of 47 States, when sold in interstate commerce or by use of the mails. H.R. Rep. No. 85, 73d Cong., 1st Sess. 10, 27-28 (1933); S. Rep. No. 47, 73d Cong., 1st Sess. 2, 4 (1933); Hearings on H.R. 4314 Before the House Committee on Interstate and Foreign Commerce, 73d Cong., 1st Sess. 29 (1933). As will be shown below, cooperative stock is subject to the blue sky laws of many States, including those of New York.

4. *Rules and Regulations of the SEC*

Contrary to defendants' contention (UHF Brief pp. 33-38), there is absolutely no inconsistency between the decision of the Court of Appeals and the Rules and Regulations of the SEC. Rule 235, 17 C.F.R. §230.235, is the only substantive rule or regulation applicable to stock in a housing cooperative. That rule exempts from *registration* the stock of certain smaller cooperative housing corpora-

406 U.S. 128 (1972) (Indians' shares of stock in mineral development corporation); SEC v. Universal Serv. Ass'n, 106 F.2d 232 (7th Cir. 1939), *cert. denied*, 308 U.S. 622 (1940) (application blanks used to solicit contributions to scientific crop growing enterprise); SEC v. Crude Oil Corp., 93 F.2d 844 (7th Cir. 1937) (bill of sale and contract for delivery of oil); SEC v. Payne, 35 F. Supp. 873 (S.D.N.Y. 1940) (contracts for the sale of silver foxes); SEC v. Tung Corp., 32 F. Supp. 371 (N.D. Ill. 1940) (contracts for cultivation and sale of tung tree acreages).

[42] An exemption from registration does not carry with it an exemption from the antifraud provisions of the federal securities laws. *See, e.g.*, Tcherepnin v. Knight, 389 U.S. 332 (1967); Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680 (5th Cir. 1971); Moore v. Gorman, 75 F. Supp. 453, 456 (S.D.N.Y. 1948). *See also* Section 17(c) of the Securities Act of 1933, 15 U.S.C. §77q(c).

tions,[43] thus implicitly recognizing that the stock of a cooperative housing corporation is a security (P-A14).

There would have been no purpose in exempting certain cooperative housing shares from registration if cooperative shares were not otherwise generally subject to the provisions of the securities laws.[44] Weiss, "Real Estate or A Security," N.Y.L.J., Nov. 18, 1974, at 1, col. 1. Similar reasoning is found in *Tcherepnin* v. *Knight*, 389 U.S. 332, 341-42 (1967) and *Carnation Co.* v. *Pacific Westbound Conference*, 383 U.S. 213, 217-18 (1970). The SEC's construction of the Act is entitled to considerable weight. As the court held in *SEC* v. *Associated Gas & Electric Co.*, 99 F.2d 795, 798 (2d Cir. 1938):

> "One of the principal reasons for the creation of such a bureau [the SEC] is to secure the benefit of special knowledge acquired through continuous experience in a difficult and complicated field. Its interpretation of the act should control unless plainly erroneous."

Cf. Stockton v. *Lucas*, 482 F.2d 979, 984 (Temp. Emer. Ct. App. 1973).

[43] Rule 235 principally exempts housing cooperatives where the par value of the offering does not exceed $300,000. It is clear that Riverbay stock did not qualify for that exemption, since its par value is $32,803,200 (*see* p. 28, *supra*).

[44] Defendants misconstrue Professor Loss's remark that this reasoning was "too facile" as applying to plaintiff's argument concerning Rule 235 (UHF Brief p. 34). Professor Loss's comment was addressed to an argument based upon Rule 15a-2 promulgated under the 1934 Act. Rule 235 had not even been adopted at the time Loss's treatise was published. That Rule is treated at page 40 of the 1962 pocket supplement to his work. There is no doubt that Professor Loss was of the view that "when the ownership of an individual apartment is evidenced by stock in the cooperative, as it usually is, the federal and state securities statutes would seem literally to apply." 1 L. Loss, Securities Regulation 492-93 (2d ed. 1961).

Securities Act Release No. 5347 (Jan. 4, 1973), [1972-73 Transfer Binder] CCH Fed. Sec. L. Rep. ¶79,163, relied upon by defendants (UHF Brief p. 36), has no bearing on cooperative shares. That release expressly applies only to "condominiums and other types of similar units." In fact, the release was issued to clarify the "uncertainty about when offerings of condominiums and other types of similar units may be considered to be offerings of securities" within the scope of the federal securities laws. There was no need to clarify the status of offerings of shares of cooperative real estate corporations, as opposed to condominium realty interests, because those offerings were already the subject of Rule 235. Indeed, Rule 235 is not even mentioned in Release No. 5347. Nor is it mentioned in the more recent release of January, 1975, in which the SEC reiterates its view that Release No. 5347 relates to "investment contracts involving condominiums" rather than shares of cooperative stock.[45] Securities Exchange Act Release No. 11,220 (Jan. 31, 1975), CCH Fed. Sec. L. Rep. ¶80,096, at 85,072 n.8.

Just as there is no substance to defendants' contention that the SEC's current position with respect to cooperatives is reflected in Release No. 5347, there is no substance to their contention that this release somehow rescinded Rule 235. When the SEC desires to rescind a Rule, it does so specifically and formally, as in the recent cases of Rules 154, 155 and 133. *See* Securities Act Release No. 5223 (Jan. 11, 1972), [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶78,487; Securities Act Release No. 5316 (Oct. 6, 1972),

[45] Condominium units by themselves have traditionally been considered real estate, whereas shares of a cooperative corporation are personal property. *Compare* N.Y. Real Prop. Law §339-g (McKinney) *with* Stockton v. Lucas, 482 F.2d 979, 983-84 (Temp. Emer. Ct. App. 1973).

[1972-73 Transfer Binder] CCH Fed. Sec. L. Rep. ¶79,015. Defendants' further contention that the Real Estate Advisory Committee to the SEC recommended that condominiums and cooperatives should be subject to the same rules (UHF Brief pp. 34-36) is beside the point. Even if that Committee did recommend that the SEC alter its view with respect to cooperative stock, the SEC did not accept the Committee's recommendation. To the contrary, the treatment of cooperative shares remains precisely as the Real Estate Advisory Committee Report described it:

> "Occupancy interests in cooperative housing are currently viewed as 'securities', primarily because such interests are represented by 'stock'." Report of the Real Estate Advisory Committee to the Securities and Exchange Commission 90 n.26 (Oct. 12, 1972).

Defendants' unqualified assertion that the SEC staff is "re-examining the Rule 235 exemption in light of the Court of Appeals decision below," citing *Society Hill Towers, Inc.*, SEC Ruling (Dec. 27, 1974), CCH Fed. Sec. L. Rep. ¶80,103 (UHF Brief p. 36 n.32), is, to say the least, disingenuous. In that letter the SEC staff announced that it was reconsidering the availability of the exemption from registration "where the aggregate purchase price . . . exceeds $300,000" even though the aggregate par value of the shares involved was less than $300,000. In other words, what the staff is apparently considering is whether to confine the registration exemption to transactions where *both* the par value and the purchase price are below $300,000.[46]

[46] None of the other no-action letters cited by defendants warrant a contrary interpretation. 900 Park Ave. Corp., SEC No-Action Letter (June 9, 1972, avail. July 10, 1972), involved an offering whose par value was $150,000. Summit House Tenants

This "re-examination," then, is still additional proof that the stock of a cooperative housing corporation is, and the SEC treats it as, a security subject to the provisions of the federal securities laws.

5. *The State Blue Sky Statutes*

All of the States active in cooperative housing treat cooperative stock as securities under their respective State blue sky laws. Thus, New York, California, Florida and Illinois have so ruled for many years.[47] Obviously, the

---

Corp., SEC No-Action Letter (Jan. 6, 1972), [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶78,611, involved an offering whose par value was stated "not to exceed $300,000" (UHF Brief p. 33 n.27). Clemson Properties, Inc., SEC No-Action Letter (Aug. 13, 1971), [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶78,387, and McCulloch Properties, Inc., SEC No-Action Letter (Aug. 30, 1973, avail. Oct. 1, 1973) did not involve Rule 235 at all (UHF Brief p. 37).

Indeed, insofar as defendants' argument rests upon the cited no-action letters, it involves a fundamental fallacy. Each of the no-action letters relates only to exemption from the registration requirements of the 1933 Act, not to the antifraud provisions of either statute, thereby confirming rather than refuting plaintiffs' argument.

[47] New York—N.Y. Gen. Bus. Law §352-e (McKinney 1968, Supp. 1974); People v. Cadplaz Sponsors, Inc., 69 Misc. 2d 417, 330 N.Y.S.2d 430 (Sup. Ct. 1972).

California—In accord with Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811, 361 P.2d 906 (1961), the Attorney General of California has ruled that shares of stock in cooperative corporations are securities under its blue sky laws. *See* Note, "Cooperative Housing Corporations and the Securities Laws," 71 Colum. L. Rev. 118, 130 n.104 (1971); Sobieski, "Securities Regulation in California: Recent Developments," 11 U.C.L.A. L. Rev. 1, 7-8 n.83 (1963); Wenig & Schulz, "Government Regulation of Condominium in California," 14 Hastings L. J. 222, 223 (1963).

Florida—"We respectfully call your attention to page 621 of the Biennial Report of the Attorney General, 1935-1936, wherein an opinion was rendered by this Commission on February 13, 1935, which gives an affirmative answer to the question of whether or not

existence and construction of similar State statutes are persuasive in interpreting federal regulatory legislation having the same purpose. Furthermore, it must be remembered that one of Congress' purposes in enacting the 1933 Act was to bring under federal control those securities which, though subject to the blue sky laws of 47 States, were being sold in interstate commerce free of such control."[48]

6. *The Legal Commentators*

The view that "stock" specifically includes cooperative stock has been expressed by virtually all of the commentators. *See* R. Jennings & H. Marsh, Securities Regulation 300 (3d ed. 1972); 1 L. Loss, Securities Regulation 492-93 (2d ed. 1961); Anderson, "Cooperative Apartments in Florida: A Legal Analysis," 12 U. Miami L. Rev. 13, 21 (1958); Comment, "Securities Regulation of Real Estate Programs," 27 Ark. L. Rev. 651, 662 & n.58 (1973); Note, "Cooperative Apartment Housing," 61 Harv. L. Rev. 1407, 1425 (1948); Note, "Cooperative Housing Corporations and the Federal Securities Laws," 71 Colum. L. Rev. 118, 127 (1971); Rifkind & Borton, "SEC Registration of Real Es-

---

stock involved in a cooperative housing venture must be registered with this Commission, and further, that the salesmen therein must also be registered. You will note the concluding paragraph of this opinion reads: 'I can find no distinction between the sale of this stock and the sale of any other "security" within the terms of the Act which would in any manner take it out of the operation of the broad definition of "security" and "sale" as given in this Act.'" "Cooperative Housing Ventures," Dec. 28, 1955, *quoted in* Anderson, "Cooperative Apartments in Florida: A Legal Analysis," 12 U. Miami L. Rev. 13, 17 n.18 (1958).

Illinois—Sire Plan Portfolios, Inc. v. Carpentier, 8 Ill. App. 2d 354 (1956); Young, "Exemptions from Registration Under the Illinois Securities Law," 1961 U. Ill. L. Rev. 205, 207.

[48] *See* p. 42, *supra*.

tate Interests: An Overview," 27 Bus. Lawyer 649, 658 (1972); Sobieski, "Securities Regulation in California: Recent Developments," 11 U.C.L.A. L. Rev. 1, 7-8 (1963); Wenig & Schulz, "Government Regulation of Condominiums in California," 14 Hastings L. J. 222, 223 (1963); Zammet, "Securities Law Aspects of Cooperative Housing," N.Y.L.J., Jan. 8, 1973, at 4, Cols. 1-7. Thus, it is clear that the commentators, like Congress, the State legislatures, the SEC, and the federal and State courts, overwhelmingly support plaintiffs' position that cooperative housing stock is a security.

B. Alternatively, the shares of common stock of Riverbay purchased by plaintiffs are "investment contracts" within the meaning of the federal securities laws.

Section 3(a)(10) of the 1934 Act further provides:

> "The term 'security' means any . . . investment contract."[49] 15 U.S.C. §78c(a)(10).

Both the District and Circuit Courts below applied this Court's classic test of an investment contract, articulated in *SEC* v. *W. J. Howey Co.*, 328 U.S. 293, 298-99 (1946):

> "[A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." (P-A15, P-B20-21)

There has never been any "serious argument [that] the first and last requirements" of the above-quoted test are

[49] Section 2(1) of the 1933 Act, 15 U.S.C. §77b(1), contains the same language.

satisfied in the instant case (P-B21). Defendants contend in support of their argument only that the Information Bulletins contain no economic inducements and, therefore, plaintiffs, when they purchased Riverbay's common stock, could have had no expectation of "profit" (UHF Brief pp. 25-32). The economic inducements which are in fact contained in the Information Bulletins are set forth at pages 25-27, *supra*. It is immaterial whether these inducements amounted to promises of "galactic profits," a condition defendants seek to engraft on the statute (UHF Brief pp. 25-26). The antifraud provisions of the securities laws are designed not only to protect those who speculate for huge returns, but to protect those who invest their savings in the expectation of a modest return. *See Tcherepnin* v. *Knight*, 389 U.S. 332, 345 (1967).

Defendants' contention with respect to expectation of profit is without basis in fact or law. Even assuming that the concept of profit is limited to direct monetary return on one's investment (UHF Brief p. 25), there is in actuality the inducement of such an expectation and the possibility of its realization in this transaction. Plaintiffs stand to realize a monetary gain on the sale of their stock in the event that Riverbay fails to exercise its right of first refusal or in the event that stock is sold to satisfy a default. See page 30, *supra*. Moreover, there is a distinct possibility of dividends and apportionment of profits, assets and earnings. The $4,269,000 income which Riverbay receives from its extensive commercial operations (361a)[50] is, after direct expenses, realized by Riverbay's stockholders as a dividend in the form of a reduction in

[50] *See* p. 29, *supra*. Contrary to defendants' assertion, the record at 361a is not "silent as to the income earned from these services" (UHF Brief p. 28), but is specific on that point.

carrying charges. In addition, if Riverbay's income from commercial tenants or enterprises exceeds the anticipated sum, or if expenses fall below the budgeted amount, dividends are mandated by statute. Private Housing Finance Law §28. The statute also provides for an apportionment of assets upon dissolution. *Id.* §35(3).

While capital gain may be the objective of many investors, it is by no means the objective of the purchasers of all instruments held to be investment contracts. For example, in *SEC* v. *Variable Annuity Life Insurance Co.*, 359 U.S. 65 (1959) the investor's motive was a higher income or yield for his premium dollars. The same was true of *SEC* v. *United Benefit Life Insurance Co.*, 381 U.S. 202 (1967). In *SEC* v. *Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973) and indeed in all "pyramid-type" sales schemes, the investor's expectation is not for a capital gain upon resale of his interest but for income from increasing the number of investors. And there was certainly no significant element of capital appreciation in *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967).

In the purchase of tax-sheltered investments, the investors' expectation is primarily, if not exclusively, focused upon the tax deductions against ordinary income available to him. There is frequently no likelihood of a capital gain at all. Yet, these investments have all been held to be securities under the federal law.[51] A similar tax induce-

[51] Examples include (1) citrus grove interests—SEC v. W. J. Howey, 328 U.S. 293 (1946); Blackwell v. Bentsen, 203 F.2d 690 (5th Cir. 1953), *cert. denied*, 347 U.S. 925 (1954); Ferland v. Orange Groves of Florida, Inc., 377 F. Supp. 690 (M.D. Fla. 1974); SEC v. Orange Grove Tracts, 210 F. Supp. 81 (D. Mass. 1962); (2) tung grove acreages—SEC v. Bailey, 41 F. Supp. 647

ment was held out to plaintiffs, to wit, the right to deduct on their individual income tax returns the portion of their monthly payments to Riverbay representing real estate taxes and mortgage interest (175a, 195a).[52] In *El Khadem* v. *Equity Securities Corp.*, 494 F.2d 1224 (9th Cir.), *cert. denied*, 95 S. Ct. 183 (1974), the court stressed that both the inducements and plaintiff's expectations consisted of a tax advantage in the right to deduct interest and investment leverage.

Further, both federal and state courts have found investment contracts present even where there was no direct monetary benefit to the investor. Thus, in *Davenport* v.

(S.D. Fla. 1941); SEC v. Tung Corp., 32 F. Supp. 371 (N.D. Ill. 1940); (3) contracts for the sale of fur-bearing animals—Miller v. Central Chinchilla Group, Inc., 494 F.2d 414 (8th Cir. 1974) (chinchillas); Ahrens v. American-Canadian Beaver Co., 458 F.2d 607 (10th Cir. 1970) (beavers); Continental Marketing Corp. v. SEC, 387 F.2d 466 (10th Cir. 1967), *cert. denied*, 391 U.S. 905 (1968) (beavers); SEC v. Payne, 35 F. Supp. 873 (S.D.N.Y. 1940) (silver foxes); (4) dairy cattle operations—American Dairy Leasing Corp., SEC Ruling (Dec. 3, 1971), [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶78,584; (5) thoroughbred horse lease and boarding agreements—Kentucky Blood Horse, Ltd., SEC Ruling, June 13, 1973, [1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶79,430; (6) oil, gas and mineral leases and drilling contracts—SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943) (oil and gas leases); SEC v. McElvain, 417 F.2d 1134 (5th Cir.), *cert. denied*, 397 U.S. 972 (1969) (oil, gas and mineral leases); Moses v. Michael, 292 F.2d 614 (5th Cir. 1969) (oil and gas leases); Price v. United States, 200 F.2d 652 (5th Cir. 1953) (oil and gas leases); (7) real estate syndications—Pawgen v. Silverstein, 265 F. Supp. 898 (S.D.N.Y. 1967).

[52] *See* Internal Revenue Code of 1954 §216, 26 U.S.C. §216; N.Y. Tax Law §615 (McKinney 1966, Supp. 1974). Defendants urge that this deduction is available to a Riverbay shareholder as a "homeowner and not because he owns a security" (UHF Brief p. 30). However, plaintiffs do not own their homes; all they own is their stock. It is upon the ownership of cooperative stock that the availability of the tax deduction is conditioned.

United States, 260 F.2d 591 (9th Cir. 1958), *cert. denied*, 359 U.S. 909 (1959), the Court of Appeals for the Ninth Circuit found that the mere expectation of employment and job security was sufficient to make a certificate of membership in a cooperative a "security." The defendants in that case were convicted under the 1933 Act of a conspiracy "to defraud in the sale of securities." 260 F.2d at 593. The "securities" were membership certificates "in the Mt. Hood Hardboard and Plywood Cooperative." *Id.* The economic inducement for the purchasers was solely:

> "that purchasers of said memberships would obtain continuous employment and job security in a large modern sawmill, plywood, and hardboard plant to be erected and owned and operated by the members thereof on a cooperative plan." *Id.*

It was neither alleged nor proved that the purchasers expected to resell their memberships at an appreciated value, or receive dividends or an apportionment of profits—the elements so stressed by defendants here. Similarly, in *State ex rel. Troy* v. *Lumbermen's Clinic*, 186 Wash. 384, 58 P.2d 812, 816 (1936), the Supreme Court of Washington held:

> "Profit does not necessarily mean a direct return by way of dividends, interest, capital account, or salaries. A saving of expense which would otherwise necessarily be incurred is also a profit to the person benefited."

The Court of Appeals correctly observed a third profit element in the instant case is the savings to plaintiffs of the difference between the cost of living in Co-op City and the rental cost of "comparable accommodations," citing

Pine Grove Manor, Inc. v. *Director*, 68 N.J. Super. 135, 171 A.2d 676 (1961); *Commonwealth* v. *2101 Cooperative, Inc.*, 27 Pa. D. & C. 2d 405 (C.P. 1961), *aff'd per curiam* 408 Pa. 24, 183 A.2d 325 (1962); *State ex rel. Russell* v. *Sweeney*, 153 Ohio St. 66, 91 N.E.2d 13 (1950) (P-A17). As one commentator recently noted, "certainly inexpensive housing vis-a-vis the generally high cost of housing is a valuable benefit to any resident, whether rich or poor." Note, "Real Estate Investments as Securities: The Sufficiency of the Howey Test," 6 St. Mary's L. J. 166, 177 (1974).

Particularly pertinent is the opinion by Chief Judge Traynor of the Supreme Court of California in *Silver Hills Country Club* v. *Sobieski*, 55 Cal. 2d 811, 361 P.2d 906 (1961). The question before the court in that case was the applicability of the California blue sky laws (whose language parallels that of the federal securities laws) to the sale of memberships in a country club; the memberships were being sold to provide funds for the construction of the club. Notwithstanding the fact that the members would have "no rights in the income or assets of the club" (361 P.2d at 907) and were entitled only to the use of the club's facilities, the court, citing and applying *Howey*, held the memberships to be securities. It viewed the purpose of the legislation as "afford[ing] those who risk their capital at least a fair chance of realizing their objectives in legitimate ventures whether . . . they expect a return on their capital in one form or [in] another." *Id.* at 909. Only because the purchasers joined together in risking their capital could there be any chance that the benefits of club membership would materialize. Hence, the court concluded:

> "the act is as clearly applicable to the sale of promotional memberships in the present case as it would be

had the purchasers expected their return in some such familiar form as dividends." 361 P.2d at 909.

Essentially the same situation obtains here, and the same result should follow: Without the $32,803,200 cash equity contributed by plaintiffs, Co-op City could not have been built and none of the attendant benefits would have materialized.

Silver Hills represents the needed enlargement of the *Howey* test to embrace those cases where the expectation of a direct monetary return is absent but there is the element of risk capital coupled with some economic benefit.

Nearly every commentator who has considered the subject approves of this result. Thus, in Coffey, "The Economic Realities of a 'Security': Is There a More Meaningful Formula?" 18 Case W. Res. L. Rev. 367, 412 (1967), the writer urges that the third element of the investment contract test should be satisfied whenever the investor is induced to expect some "reasonable benefit over and above the initial investment." Another commentator states that the benefit need not be "material or tangible and certainly not payable in money alone." Long, "An Attempt to Return 'Investment Contracts' to the Mainstream of Securities Regulation," 24 Okla. L. Rev. 135, 167 (1971). The salutary effect of *Silver Hills* is noted by yet another writer, who observes that under the ruling in that case "the absence of a profit motive does not provide a shield for the unscrupulous promoter who seeks to finance his operation by public solicitation of risk capital." Hannan & Thomas, "Defining Federal Securities," 25 Hastings L.J. 219, 233 (1974). *See also* Note, "Cooperative Housing Corporations and the Federal Securities Laws," 71 Colum.

L. Rev. 118, 130 (1971); Note, "Real Estate Investments as Securities: The Sufficiency of the Howey Test," 6 St. Mary's L.J. 166, 167-68, 175 (1974).

At least one Circuit Court has embraced the risk capital test where the traditional elements of profit were absent. In *El Khadem* v. *Equity Securities Corp.*, 494 F.2d 1224 (9th Cir.), *cert. denied*, 92 S. Ct. 183 (1974), the court explained:

"In return for supplying Nationwide with venture capital, Ms. El Khadem received a tax benefit and investment leverage." 494 F.2d at 1226.

• • •

"Second, appellants contend that Ms. El Khadem did not share in the profits of Nationwide. She was, however, provided a financial incentive by Nationwide to invest in their plan in the form of an opportunity to gain a tax advantage and to acquire investment leverage." *Id.* at 1229.

• • •

"In conclusion, the Nationwide plan was an investment of risk capital. Ms. El Khadem risked financial loss in order to gain certain financial advantages. Nationwide sought the use of Ms. El Khadem's capital, in the form of credit and collateral, for its own business purposes. Ms. El Khadem's risk depended on the skill with which Nationwide conducted its business ventures and managed her collateral and promissory note. It is precisely this type of risk venture that the Securities Act of 1933 and the Securities Exchange Act of 1934 were designed to control. Therefore, we hold that the Nationwide plan was a security as defined by the Acts." *Id.* at 1229-30.

See also Hurst v. *Dare To Be Great, Inc.*, 474 F.2d 482 (9th Cir. 1973); *Venture Investment Co., Inc.* v. *Schaefer*, 3 Blue Sky L. Rep. ¶71,031 (D. Colo. 1972), *aff'd on other grounds*, 478 F.2d 156 (10th Cir. 1973); *Murphy* v. *Dare To Be Great*, 3 Blue Sky L. Rep. ¶71,053 (D.C. Super. Ct. 1972); *Bond* v. *Koscot Interplanetary, Inc.*, 276 So. 2d 198 (Fla. App. 1973); *Frye* v. *Taylor*, 263 So. 2d 835 (Fla. App. 1972); *Florida Discount Centers, Inc.* v. *Antinori*, 226 So. 2d 693 (Fla. App. 1969), *aff'd*, 232 So. 2d 17 (Fla. 1970); *State ex rel. Commissioner of Securities* v. *Hawaii Market Center, Inc.*, 52 Hawaii 642, 485 P.2d 105 (1971); *State ex rel. Park* v. *Glenn Turner Enterprises, Inc.*, 3 Blue Sky L. Rep. ¶71,020 (Idaho Dist. Ct. 1972); *State ex rel. Healy* v. *Consumer Business Systems, Inc.*, 482 P.2d 549 (Ore. Ct. App. 1971).

From the point of view of the defrauded purchaser who has furnished risk capital, it makes little difference whether the economic benefit he expected was in the form of a direct monetary return. The risk is nonetheless present. As the Court of Appeals reasoned in this case, "if the corporation [Riverbay] went bankrupt, the shareholders would have sustained a loss in the amount of their investment" (P-A18).

Ultimately, plaintiffs alone must bear this risk. Neither the state, the sponsor (UHF), nor the contractor (CSI) put up one penny of venture capital. The first $32,803,200 was put up by plaintiffs and the rest was borrowed from the Agency, which received a first mortgage to secure repayment in full.[53] Plaintiffs are providing Riverbay with the funds to repay the interest and amortization on that

[53] Admitted in UHF Brief p. 8 n.7.

mortgage. Surely plaintiffs' shares qualify as investment contracts under the risk capital test. With equal certainty, application of that test would ensure a just result.

C. Alternatively, the shares of common stock of Riverbay purchased by plaintiffs are "instruments commonly known as a 'security'" within the meaning of the statutory definition.

Section 3(a)(10) of the 1934 Act further provides:

> "The term 'security' means . . . any instrument commonly known as a 'security.'" 15 U.S.C. §78c(a)(10).[54]

Not only are the shares of common stock of Riverbay either "stock" and "investment contracts," but they also qualify under a third alternative definition which includes "any instrument commonly known as a 'security.'"

Over a quarter of a century ago, in *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943), this Court said:

> "Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts,' or as 'any interest or instrument commonly known as a "security."'"

Precisely such a "novel, irregular and uncommon device," a pyramid sales scheme, came before the District Court in *SEC* v. *Glenn W. Turner Enterprises, Inc.*, 348 F. Supp. 766 (D. Ore. 1972). The court found the scheme to be a

[54] Similar but even broader language appears in Section 2(1) of the 1933 Act, 15 U.S.C. §77b(1).

"security" because it was both an "investment contract" and an "interest or instrument commonly known as a security." [55] *Id.* at 733.

In applying the latter language, the court first noted:

> "[A]s a principle of statutory construction, these general categories cannot be disregarded or construed as devoid of meaning. Considering the nature of these statutes, the inclusion of these general phrases is yet another indication of the strength of the congressional desire that the statute be interpreted broadly, flexibly and liberally. Congress wanted to provide no loopholes for promotions in conflict with the purposes of the securities laws." *Id.* at 773.

The Court further stated that it doubted

> "Congress intended that in order to qualify under these general categories, a transaction must be commonly known to the man in the street as a security. Most securities are rather technical in nature and not likely to be understood except by the legal or financial community. It is sufficient that an offering be considered as a legal matter to be a security, regardless of the popular perception of it. Since the Supreme Court has indicated that it is appropriate to look to state law to give content to the terms used in the definition, *Howey, supra*, state decisions may be a most trustworthy authority on what is commonly known as a security." *Id.* at 773.

---

[55] On appeal, the Court of Appeals affirmed on the first ground, without reaching the second. 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973).

The court found two types of state decisions relevant: (1) decisions holding investment arrangements similar on their facts to be securities within the meaning of the applicable blue sky laws, and (2) decisions applying the risk capital analysis to investment arrangements, regardless of their similarity on the facts.

There is no question that this type of stock is "commonly known as a 'security'" in New York State. See p. 46, *supra*. Indeed upon the recommendation of the Attorney General, New York's blue sky law was amended in 1968 to require that the stock of cooperatives formed pursuant to the Mitchell-Lama Act, along with all other securities, be registered with the Attorney General. N.Y. Laws, 1968, ch. 1085. In his memorandum to the New York Legislature, the Attorney General, quoting from a 1966 report of the State Commission of Investigation, urged:

> "The law as presently constituted exempts limited profit housing companies from filing such a prospectus with the Attorney General.
>
> "The purpose of the present law is to protect the public against fraud and misrepresentations in the sale of interests in real estate, including cooperative apartments. The sale of cooperative 'luxury' apartments, as well as the sale of cooperative apartments in privately financed housing developments whose mortgages are insured by the Federal Housing Administration, are subject to the provisions of this section. However, under the present law, housing companies organized under the New York State Limited-Profit Housing Companies Law, are specifically exempted from the disclosures and filing require-

ments of §352-e, subdivision 1. Surely prospective middle-income tenant-cooperators are entitled to and should receive the same protection as those in the high income, 'luxury' class." *Id.* at 2340.

Thus, the reasoning of *Glenn Turner*, applied to the facts of the case at bar, compels the conclusion that Riverbay shares are "instruments commonly known as a 'security.'"

Similarly, Riverbay shares would also qualify as "securities" under this Court's alternative formulation in *Joiner* because they were "widely offered." See p. 57, *supra.*

D. Congress has mandated application of the federal securities laws to interstate sales of stock regardless of state regulation.

There is no provision in the federal securities laws which exempts securities because they are subject to state regulation or are issued by a corporation subject to such regulation, nor is there any language from which such an exemption can be implied. To the contrary, Congress made a considered determination not to exempt state-regulated securities from federal jurisdiction, stating:

> "The exemptions do not include the securities of public utilities and others more or less supervised by the respective State blue sky commissions. . . . State laws have failed to meet the present situation in the sale of utility and other securities in interstate commerce, with resultant loss to our people of billions of dollars." S. Rep. No. 47, 73d Cong., 1st Sess. 4 (1933).

Indeed, congressional dissatisfaction with the ineffectiveness of State regulation was an important factor leading

to the 1933 and 1934 Acts.[58] S. Rep. No. 47, 73d Cong., 1st Sess. 2 (1933).

As noted at page 46, *supra,* shares of stock in cooperative housing corporations are uniformly regarded as subject to the State blue sky laws. This is certainly true with respect to cooperative housing stock in New York. *See* UHF Brief p. 39 and *People* v. *Cadplaz Sponsors, Inc.*, 69 Misc. 2d 417, 330 N.Y.S.2d 430 (Sup. Ct. 1972). And if there were ever any doubt as to shares of Mitchell-Lama stock, it has been put to rest by the State Attorney General himself. *See* pp. 59-60, *supra.*

In accordance with the expressed congressional purpose, this Court has not hesitated to extend the federal securities laws to interstate purchases and sales of securities subject to State blue sky laws regardless of whether they were also the subject of a "heavily regulated state statutory scheme" (UHF Brief p. 38). Thus, in *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967), the Court applied the federal securities laws to withdrawable capital shares in a state-chartered and state-supervised savings and loan association. Similarly, in *SEC* v. *Variable Annuity Life Insurance Company*, 359 U.S. 640 (1959), where the Court noted initially that the defendants were "regulated under the insurance laws of the District of Columbia and several other States" (*Id.* at 642), those laws were held applicable to so-called variable annuity contracts. As Mr. Justice Brennan observed in the concurring opinion:

---

[58] The State Attorney General's failure to act in the present situation, in contrast with his vigorous prosecution of People v. Cadplaz Sponsors, Inc., 69 Misc. 2d 417, 330 N.Y.S.2d 430 (Sup. Ct. 1972), a case involving virtually identical facts, strongly suggests that the congressional reasoning is no less compelling today.

> "Concurrent regulation . . . was contemplated by the Acts as a quite generally prevailing matter. Nor is it rational to assume that Congress thought that *any* business whatsoever regulated by a specific class of officials . . . would be for that reason so perfectly conducted and regulated that all the protections of the Federal Acts would be unnecessary." *Id.* at 647 (emphasis in original).

The concurring opinion concludes with an especially apt passage:

> "Congress regulates by general statutes. The passage of a federal regulatory statute is a delicate balancing of many national legislative interests and political forces. Congress need not go through the initial travail of a reenacting its general regulatory scheme every time a new form of enterprise is introduced, if that new form falls within the scheme's coverage. If there is deemed wise any adjustment of the regulatory scheme, Congress may make it." *Id.* at 657.

Even defendants do not claim that Congress has in any way "adjusted" the federal securities laws to *exclude* cooperative housing stock.

Nor can any such Congressional intention be inferred from a fair reading of the several "housing" statutes cited by defendants (UHF Brief p. 42 *et seq.*). The Interstate Land Sales Full Disclosure Act, 15 U.S.C. §§1701-1720, deals, not with securities, but with the interstate sale or lease of certain undeveloped *land*. To have placed supervisory authority over land in the SEC rather than HUD would necessarily have involved an enlargement of the

SEC's jurisdiction,[87] for under ordinary circumstances land *per se* is not a security. Significantly, those real-estate related instruments which are commonly regarded as securities, namely, "evidences of indebtedness secured by a mortgage or deed of trust on real estate" and "securities issued by a real estate investment trust," are expressly exempted from the statute. 15 U.S.C. §1702(5)-(6).

Equally unrelated to the purchase and sale of securities is the Real Estate Settlement Procedures Act of 1974, Pub. L. No. 93-533 (Dec. 22, 1974). As the title suggests, this statute deals solely with the "closing" of federally-related mortgage transactions. It is intended "to help persons borrowing money . . . better to understand the nature and costs of real estate settlement services." *Id.* §5(a). Such services are stated to include "title searches, title examinations, the provision of title certificates, title insurance, services rendered by an attorney, the preparation of documents, property surveys, the rendering of credit reports or appraisals, pest and fungus inspections, services rendered by a real estate agent or broker, and the handling of the processing, and closing or settlement." *Id.* §3(3). The difference between a property survey, title policy, or an attorney's bill for services, and a public offering of shares of stock, scarcely needs belaboring.

---

[87] The Department of Commerce quotation at page 44 of the UHF Brief is misleading in several respects. Although not disclosed, it is taken from the Senate *Minority* Report. Further, it applies to the 1966 bill, which the Commerce Department, like the Department of Justice and the Post Office Department, opposed *in toto*, not on the ground that the SEC was proposed as the supervisory authority, but on the ground that no federal legislation was necessary. S. Rep. No. 1123, 90th Cong., 2d Sess. 198 (1968). In 1967, "the Federal Agencies reversed their oppositions and supported the legislation." *Id.*

As for Section 821 of the Housing and Urban Development Act of 1974, 42 U.S.C. §3532 (*see* UHF Brief pp. 42-43), we would note that, contrary to defendants' contention, Congress has not "thereby indicated that housing cooperatives should be federally regulated, if at all, by housing laws administered by HUD." *Id.* p. 42. Indeed, in introducing this legislation, Representative Rosenthal was severely critical of HUD.[58] Moreover, he was at pains to clarify the limited purpose of the statute:

> "I want to make it clear that the amendment requires a study only—it does not add to or change in any way laws affecting landlord-tenant relations or condominium or cooperative construction, sales, or ownership." 120 Cong. Rec. 5371 (daily ed. June 20, 1974).

As those laws now stand, a public offering of shares in a cooperative housing corporation is within the ambit of the antifraud provisions of the federal securities laws. Neither theoretically nor practically is there or need there be any conflict between federal housing legislation and securities law jurisdiction. Nor would a finding of securities law jurisdiction upset the federal-state balance. The fact is, such a finding would implement the congressional purpose and preserve precisely the regulatory relationship envisioned by Congress.

---

[58] Representative Rosenthal commented: "HUD has done virtually nothing to come to grips with the human and public-policy implications posed by the condominium boom. So far as I have been able to discover, those HUD 'consumer' information publications that do deal with the subject merely describe the nature of condominium ownership, or promote its alleged advantages. Nowhere are questions addressed relating to the shortcomings of such ownership or its negative impact on renters. 120 Cong. Rec. 5372 (daily ed. June 20, 1974).

POINT II

The defense of immunity under the Eleventh Amendment is not available to the Agency and has been waived by the State.

A. The Agency cannot assert the defense of Eleventh Amendment immunity.

The Agency has raised the affirmative defense that the District Court lacks jurisdiction over the person of the Agency because of the Eleventh Amendment to the United States Constitution.[59] That Amendment provides:

> "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State."

Thus, by its specific terms, the immunity conferred is limited to "one of the United States." The Agency is neither a State, nor its *alter ego*, and therefore does not come within the ambit of the Eleventh Amendment.

The Agency is neither a department nor a division of the State. It is a "public benefit corporation" with the power "to sue and be sued." Private Housing Finance Law §44. It is a separate "legal public entity." [1972] Op. N.Y. Att'y Gen. No. 56-B. By statute, the State is not liable

---

[59] Except insofar as it attacks the construction that the Second Circuit placed upon Section 32(5) of the Private Housing Finance Law (N.Y. Brief p. 12), the New York brief does not distinguish between State and Agency for purposes of the immunity defense. With respect to the Agency, the question of waiver need never be reached. Accordingly, discussion of that question is deferred to Point II, subdivision B of this brief, dealing with the State.

for the Agency's notes or bonds, which are not debts of the State.[60] Private Housing Finance Law §46(8).

It has been repeatedly held, by federal and New York courts alike, that substantially similar governmental entities do not have immunity under the Eleventh Amendment. *See Matherson* v. *Long Island State Park Commission,* 442 F.2d 566 (2d Cir. 1971); *International Longshoremen's Association* v. *North Carolina State Ports Authority,* 370 F. Supp. 33 (E.D.N.C. 1974); *Prendergast* v. *Long Island State Park Commission,* 330 F. Supp. 438 (E.D.N.Y. 1970); *Zeidner* v. *Wulforst,* 197 F. Supp. 23 (E.D.N.Y. 1961); *New York Dormitory Authority* v. *Span Electric Corp.,* 18 N.Y.2d 114, 271 N.Y.S.2d 983 (1966); *Story House Corp.* v. *New York Job Development Authority,* 37 App. Div. 2d 345, 325 N.Y.S.2d 659 (3d Dep't 1971), *aff'd mem.,* 31 N.Y.2d 942, 340 N.Y.S.2d 929 (1972); *Braun* v. *State,* 203 Misc. 563, 117 N.Y.S.2d 601 (Ct. Cl. 1952); *Ciulla* v. *State,* 191 Misc. 528, 77 N.Y.S.2d 545 (Ct. Cl. 1948).

Whitten v. *State University Construction Fund,* 493 F.2d 177 (1st Cir. 1974); *Charles Simkin & Sons, Inc.* v. *State University Construction Funds,* 352 F. Supp. 177 (S.D. N.Y.), *aff'd mem.,* 486 F.2d 1393 (2d Cir. 1973) and *State*

[60] The New York Brief is less than candid when it states:

> "[If] the purpose of this litigation is to impose any liability upon the Agency, that liability may be borne ultimately by the State itself, regardless of any prior statutory commitments or prohibitions." N.Y. Brief p. 12.

The fact is, the State has carefully insulated itself from any legal liability for the debts of the Agency or for its notes or bonds. If, by the mere expedient of a voluntary contribution to a separate "legal public entity" a State can confer immunity under the Eleventh Amendment, then every city, town, village and school district which receives State aid could claim immunity. This is certainly not the case.

University of New York v. *Syracuse University,* 206 Misc. 1003, 137 N.Y.S.2d 916 (Sup. Ct.), *aff'd,* 285 App. Div. 59, 135 N.Y.S.2d 539 (3d Dep't 1954) are all distinguishable.[61] The two entities involved in those cases, the State University Construction Fund and the University of the State of New York, unlike the Agency, are not fiscally independent but totally dependent upon the State for all their funds. A judgment against either would be, in effect, a judgment against the State itself. A judgment against the Agency, on the other hand, would not be enforceable against the State.

Neither the language of the Constitution itself nor the cases support any claim of immunity on the part of the Agency.

B. The defense of Eleventh Amendment immunity has been waived by the State both by statute and by conduct.

1. *The defense has been waived by statute*

To the extent that the Eleventh Amendment defense may be applicable to the State, it has been expressly waived by statute. Section 32(5) of the Private Housing Finance Law unequivocally provides:

> "With regard to duties and liabilities arising out of this article[62] the state, the commissioner or the supervising agency may be sued in the same manner as a private person."

[61] *See* N.Y. Brief p. 18. The latter two cases are not cited in the New York Brief. However, we call them to the Court's attention.

[62] At page 3 of its petition, the State concedes that "this article" comprises the entire Mitchell-Lama Act.

The word "liability" is a term "of the most comprehensive significance, 'ncluding almost every character of hazard or responsibility, absolute, contingent, or likely." Black's Law Dictionary 1059 (rev. 4th ed. 1968). *See also Mayfield* v. *First National Bank*, 137 F.2d 1013, 1019 (6th Cir. 1943).

As indicated above, the supervisory duties of the State through the Commissioner with respect to cooperative housing constructed and sold under "this article" are all-pervasive. The Commissioner is, *inter alia*, charged with responsibility to see that Riverbay complies "with law."[63] Private Housing Finance Law §32(1). Thus, if Riverbay's stock were sold in violation of the antifraud provisions of the federal securities laws, then the State failed to carry out its duty under "this article" and could "be sued in the same manner as a private person."

Waivers of immunity by a state couched in similar and even less comprehensive language than that employed in Section 32(5) of the Private Housing Finance Law have been construed as a consent to suit in the federal court. *See, e.g., Petty* v. *Tennessee-Missouri Bridge Commission*, 359 U.S. 275 (1959) (authority "to sue and be sued in its own name"); *Flores* v. *Norton & Ramsey Lines., Inc.*, 352 F. Supp. 150 (W.D. Tex. 1972) ("[e]ach unit of government in the state shall be liable for money damages . . . where such unit of government, if *a private person*, would be liable to the claimant in accordance with the law of this State") (emphasis added); *Vincent* v. *P. R. Matthews Co.*, 126 F. Supp. 102 (N.D.N.Y. 1954) ("a public improvement [lien]

[63] "Law," as employed in other statutes, has been interpreted by the New York courts to mean "laws of the land." Kent v. Quicksilver Mining Co., 78 N.Y. 159, 182 (1879); Raub v. Gerkin, 127 App. Div. 42, 44, 111 N.Y.S. 319, 320 (2d Dep't 1908).

may be enforced against the funds of the state . . . in the same court and in the same manner as a mechanics lien on real property").[64]

In the footnote on page 12 of its brief, the State describes Section 32(5) as a "suability provision." In effect the State thus concedes that Section 32(5) is a waiver of Eleventh Amendment immunity. This phrase can have no other meaning because the only immunity from suit which the "commissioner" and "supervising agency"[65] ever enjoyed was in their official capacities as agents of the State. *See* cases cited at p. 66, *supra*. It follows that the language of the statute must be read as a waiver of that immunity.

The State also contends that Section 32(5) should be construed only as a waiver to suit in the state courts and not as including suits in the federal courts (N.Y. Brief p. 13), a distinction which finds no support in the language employed. The New York Legislature has frequently provided for limited waivers of sovereign immunity, in each instance employing entirely different language to indicate its intention to waive immunity only in the state courts.[66]

[64] The statute involved in Knight v. New York, 443 F.2d 415 (2d Cir. 1971), cited at pages 11, 12 and 18 of the New York brief, was N.Y. Real Prop. Actions Law §1541 (McKinney 1963), which provides only that "an action may be maintained . . . by or against the people of the State of New York," a provision totally different from Section 32(5).

[65] The Agency is correct in its contention that it is not a "supervising agency" within the meaning of Section 32(5) (N.Y. Brief p. 12). However, the argument based on this contention is immaterial. As explained in the first subdivision of this point, the Agency has no immunity to waive.

[66] *See, e.g.*, N.Y. Aband. Prop. Law §215 (McKinney Supp. 1974) ("[s]uch party . . . may certify such facts to the court of claims"); N.Y. Agric. & Mkts. Law §27(13) (McKinney 1972)

So far as plaintiffs can ascertain from a reading of reported decisions involving statutory waiver of Eleventh Amendment immunity, there is no provision in the laws of any other State whose language is similar to Section 32(5).[67] Consequently, to affirm the holding of the Second Circuit on the basis of statutory waiver would not appear to have any effect upon any other State. Even as to New York, the effect would be extremely limited.

2. *The defense has been waived by conduct*

Both New York and Ohio concede that States may waive their immunity under the Eleventh Amendment by conduct and that Congress may require "States to waive this immunity as a condition of participating in activities regulated by the federal government," citing *Parden* v. *Terminal Railway of Alabama Docks Department*, 377 U.S.

("[t]he owner . . . may present to the court of claims a claim"); N.Y. Canal Law §§40(14), 85 and 120 (McKinney Supp. 1974) §40(14)—[t]he owner . . . may present to the court of claims a claim"; §85—[e]ach person . . . may present a claim for damages against the state to the court of claims"; §120—damages to be ascertained and determined . . . before the court of claims"); N.Y. Correc. Law §27(13) (McKinney 1968) ("[t]he owner . . . may present to the court of claims a claim"); N.Y. Educ. Law §307(13) (McKinney 1969) ("[t]he owner . . . may present to the court of claims a claim"); N.Y. Environmental Conservation Law, §§15-1717(4), 15-1739(6) (McKinney 1973) (§15-1717(4)—"the licensee may recover the balance in the Court of Claims'" §15-1739(6)—"the damages may be in like manner recovered in the Court of Claims"); N.Y. H'way Law §29(14) (McKinney 1962) ("[a]ny owner may present to the court of claims a claim"); N.Y. Mental Hygiene Law §71.33 (McKinney Supp. 1974) ([t]he owner . . . may present to the court of claims a claim"); N.Y. State Law §59-b (McKinney 1952) ("the court of claims shall have jurisdiction to determine the amount of such compensation").

[67] Ohio's failure to address the express waiver question suggests that its laws contain no similar provision. *See* Ohio Brief, p. 2.

184 (1964) (Ohio Brief p. 6; N.Y. Brief p. 5).[68] In *Edelman* v. *Jordan*, 415 U.S. 615, 678 (1974), this Court stated that the issue:

> "[t]urns on whether Congress has intended to abrogate the immunity in question, and whether the State, by its participation in the program authorized by Congress, had in effect consented to the abrogation of that immunity."[69]

Thus, in the first instance, the question becomes one of determining Congress' intent from the legislative history and the statutory scheme.

With respect to this question, the statutory definition of two terms is relevant: (1) the definition of "person" in Section 2(2) of the 1933 Act, 15 U.S.C. §77b(2), and Section 3(a)(9) of the 1934 Act, 15 U.S.C. §78c(a)(9), and (2) the definition of "security" in Section 2(1) of the 1933 Act, 15 U.S.C. §77b(1) and Section 3(a)(10) of the 1934 Act, 15 U.S.C. §78c(a)(10). There can be no doubt that Congress meant to include States within the definition of "persons." In H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933), Congress declared:

[68] It should be noted that Ohio's entire brief is directed at a straw man. Ohio's contention that the Second Circuit "required States to waive their Eleventh Amendment immunity as a condition of concurrently regulating the issuance and sale of securities" (Ohio Brief pp. 3, 10, 12-14) is completely in error. The Second Circuit did not so hold, and plaintiffs make no such contention. The Second Circuit did correctly hold, however, that in adopting the 1934 Act, Congress required States to waive their Eleventh Amendment immunity as a condition of engaging in the "sale and distribution of securities" (P-A22).

[69] Both New York and Ohio adopt this test (N.Y. Brief pp. 6-7, Ohio Brief pp. 6, 9).

> "Paragraph (2) [of the 1933 Act] defines 'person' in terms sufficiently broad to include within that concept not only an individual but also every form of commercial organization that may issue securities. *It includes within the concept of a 'person' a government or a political subdivision thereof,* although later sections of the bill exempt from its provisions securities issued by the U.S., a State or a territory, or a political subdivision of any of these governmental units." (emphasis added).

See also Id. at 14; Hearings on H.R. 7852 and 8720 Before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 298, 720-21, 753 (1934); Hearings on S. Res. 56, 84 and 97 Before the Senate Committee on Banking and Currency, 73d Cong., 1st Sess. 6903, 7038, 7446 (1934).

During the extensive hearings on both statutes, concern was expressed that the classification of States, municipalities and political subdivisions as "persons" would subject their securities to the registration requirements, thereby impairing the value and marketability of state, municipal and quasi-governmental bonds. *See* Hearings on H.R. 7852 and 8720 Before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 298, 720-721, 753 (1934); Hearings on S. Res. 56, 84 and 97 Before the Senate Committee on Banking and Currency, 73d Cong., 1st Sess. 6903, 7038, 7446 (1934). Congress did *not* respond by changing the definition of "person," but rather by amending the definition of "exempted security" to encompass "securities which are direct obligations of or obligations guaranteed as to principal or interest by a State or

any political subdivision thereof." 1934 Act §3(a)(12), 15 U.S.C. §78c(a)(12); *cf.* 1933 Act §3(a)(2), 15 U.S.C. §77(a)(2). *See* Hearings on S. Res. 56, 84 and 97 Before the Senate Committee on Banking and Currency, 73d Cong., 1st Sess. 7543-44 (1934); Hearings on H.R. 4314 Before the House Committee on Interstate and Foreign Commerce, 73d Cong., 1st Sess. 29 (1933); Hearings on S. 875 Before the Senate Committee on Banking & Currency, 73d Cong., 1st Sess. 65-66, 232-33 (1933). Obviously, Riverbay's stock does not qualify as an exempted security; it is neither the direct obligation of a State nor guaranteed by a State. In any event, the exemption is only from registration. Insofar as the definition of "person" remains unaltered, a State and its political subdivisions remain subject to the antifraud provisions of the federal securities laws. The only reported decision in point so holds. *Baron* v. *Shields*, 131 F. Supp. 370 (S.D.N.Y. 1955).

The very question here involved was determined in *Parden* v. *Terminal Railway of Alabama Docks Department,* 377 U.S. 184 (1964). In that case, citizens of Alabama brought a personal injury action pursuant to the Federal Employers Liability Act, 45 U.S.C. §§51 *et seq.*, against a railroad owned and operated by the State of Alabama. The courts below dismissed on the ground that under the Eleventh Amendment, Alabama was immune from suit. This Court reversed and in a rationale wholly applicable to the present case stated:

> "Our conclusion is simply that Alabama when it began operation of an interstate railroad approximately 20 years after the enactment of the FELA, necessarily consented to such suit as was authorized by that Act. By adopting and ratifying the Commerce Clause, the

States empowered Congress to create such a right of action against interstate railroads; by enacting the FELA in the exercise of this power, Congress conditioned the right to operate a railroad in interstate commerce upon amenability to suit in federal court as provided by the Act; by thereafter operating a railroad in interstate commerce, Alabama must be taken to have accepted that condition and thus to have consented to suit."

• • •

"A State's immunity from suit by an individual without its consent has been fully recognized by the Eleventh Amendment and by subsequent decisions of this Court. But when a State leaves the sphere that is exclusively its own and enters into activities subject to congressional regulation, it subjects itself to that regulation as fully as if it were a private person or corporation." 377 U.S. at 192, 196.[70]

---

[70] *See also* Pennsylvania Environmental Council, Inc. v. Bartlett, 454 F.2d 613, 625 (3d Cir. 1971) (participation in federal-state highway program) (dictum); Named Individual Members of the San Antonio Conservation Society v. Texas Highway Department, 446 F.2d 1013, 1028 (5th Cir. 1971), *cert. denied*, 406 U.S. 933 (1972) (participation in federal-state highway program); Chesapeake Bay Bridge & Tunnel District v. Lauritzen, 404 F.2d 1001, 1003-04 (4th Cir. 1968) (occupation of navigable waters with bridge and tunnel); Owens v. Roberts, 377 F. Supp. 45, 56 (M.D. Fla. 1974) (participation in federal-state welfare program); Lemelson v. Ampex Corp., 372 F. Supp. 708, 712 (E.D. Ill. 1974) (purchase of patented machinery incorporating infringing devices); International Longshoremen's Association v. North Carolina State Ports Authority, 370 F. Supp. 33, 38 (E.D.N.C. 1974) (operation of interstate railroad); Principe Compania Naviera, S.A. v. Board of Commissioners, 333 F. Supp. 353, 356 (E.D. La. 1971) (operation of maritime facilities); Rivet v. East Point Maritime Corp., 325 F. Supp. 1265, 1267 (S.D. Ala. 1971) (stevedoring operations).

The facts in the instant case are even more compelling than those in *Parden*. There, the legislative history of the FELA was silent as to the inclusion of States within the statutory scheme.[71] Here, Congress explicitly intended to include States. Further, *Parden* involved a statute conferring concurrent state and federal jurisdiction (*see* 45 U.S.C. §56) so that it was possible to deny access to a federal forum without depriving private suitors of a remedy against States. Here, a denial of access to the federal forum would effectively foreclose all relief under the 1934 Act because jurisdiction is vested exclusively in the federal courts.[72]

The federal securities laws were enacted in 1933 and 1934. As the State itself concedes, "Not until 1955, with the enactment of . . . the Mitchell-Lama Law, did New York authorize the form of housing company involved in this litigation." N.Y. Brief p. 16. Thus, when the State enacted the Mitchell-Lama Act in 1955, more than twenty years after enactment of the federal securities laws, it actively embarked upon the interstate solicitation of risk capital through the sale of cooperative housing stock with clear knowledge of the existing federal regulatory scheme.

---

[71] This point was the basis of the dissenting opinion. 377 U.S. 198-200.

[72] Indeed, if this Court were to accept the arguments advanced by New York and Ohio, that there is no private right of action under Section 17(a) of the 1933 Act (Ohio Brief p. 7; N.Y. Brief p. 6), *all* relief under the federal securities laws would be foreclosed. Of course, there is substantial authority opposed to defendants' position. *See, e.g.*, Katz v. Amos Treat & Co., 411 F.2d 1046 (2d Cir. 1969); Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951); Mincola v. Arthur-Hardgrove Co., [1964-66 Transfer Binder] CCH Fed. Sec. L. Rep. ¶91,608 (S.D.N.Y. 1965); Pfeffer v. Cressaty, 233 F. Supp. 756 (S.D.N.Y. 1963); Thiele v. Shields, 131 F. Supp. 416 (S.D.N.Y. 1955); Osborne v. Mallory, 86 F. Supp. 869 (S.D.N.Y. 1949).

The State's historical discourse on its housing legislation from 1926 to the present (N.Y. Brief pp. 14-16) is beside the point. There was no housing statute prior to the Mitchell-Lama Act in 1955 which was keyed to a statutory plan for raising risk capital by the public solicitation of subscriptions for the common stock of the housing company. The original State Housing Law, N.Y. Laws, 1926, ch. 823, established an entirely different statutory plan. That plan was designed to encourage private investors to form so-called limited dividend housing companies which would undertake residential housing projects subject to the regulation of a newly created State Board of Housing. *See Id.* §30(2). The apartments constructed or acquired by such housing companies were to be *rented, not sold,* to the occupants. *See Id.* §§16, 21, 38(8) and 42.

The State's historical discourse in no way alters the fundamental rule that voluntary entry into a federally regulated sphere must be construed as a waiver by conduct of Eleventh Amendment immunity. *Parden* v. *Terminal Railway of Alabama Docks Department,* 377 U.S. 184 (1964). Nor, despite the contentions of New York and Ohio, is that rule in any way vitiated by this Court's decisions in *Edelman* v. *Jordan,* 415 U.S. 651 (1974), and *Employees* v. *Missouri Public Health Department,* 411 U.S. 279 (1973), both of which cases cited *Parden* with approval. Both *Edelman* and *Employees* are entirely distinguishable on the facts.

First, in this case there is a clear, unequivocal statutory waiver by the State; in *Edelman* and *Employees* there was none.

Second, unlike *Edelman* and *Employees,* in the instant case the State is not carrying out a purely governmental

function. Contrary to New York's contention, it is not merely regulating securities issued by others. The sale of cooperative stock to the public is a *sine qua non* of the Mitchell-Lama Act. Private Housing Finance Law §§22(2), 25 and 26(1)(b). The initial risk capital *must* come from the stockholders. The State also derives millions of dollars in revenue from supervision fees; $3,510,000 in this case alone. Fees of this dimension are hardly comparable to the nominal filing fees which customarily accompany blue sky registrations. Clearly, the State has acted in a proprietary and not in a governmental role[73] in the present case.

Third, unlike the statute in *Edelman,* where this Court found that the Social Security Act did not create a private cause of action, or in *Employees,* where there was concurrent jurisdiction in the State courts, Congress, in enacting the 1934 Act, specifically and affirmatively placed exclusive jurisdiction for violations thereof in the federal courts, thereby indicating its determination to condition a State's future activities in the areas circumscribed by the Act

---

[73] *Cf.* International Longshoremen's Association v. North Carolina State Ports Authority, 370 F. Supp. 33 (E.D.N.C. 1974).

MacKethan v. Virginia, 370 F. Supp. 1 (E.D. Va.), *aff'd per curiam,* Civ. No. 74-1249 (4th Cir. Dec. 23, 1974), and the unreported decisions, Matthews v. Fisher, No. C-1-74-284 (S.D. Ohio, April 16, 1974), *appeal docketed sub nom.* Yeomans v. Kentucky Department of Banking and Securities, No. 74-2003 (6th Cir., September 4, 1974), and DeVoe v. Ostrander, No. C-3-74-95 (S.D. Ohio, October 18, 1974), cited at pages 10 and 18 of the New York Brief as evidencing a contrary view, are both poorly reasoned and distinguishable on their facts. In all of those cases, the district courts distinguished *Parden* without giving any consideration to the legislative history showing Congress' expressed intent to include States as "persons" within both the 1933 Act and the 1934 Act. Further, in those cases, the State's role was purely regulatory in the traditional sense.

upon a waiver of Eleventh Amendment immunity. 1934 Act §27, 15 U.S.C. §78aa.[74]

Fourth, the statutes involved in *Edelman* and *Employees* do not involve the same policy considerations as underlie the federal securities laws. We are dealing here with two statutes whose salutary remedial purposes have been consistently upheld and extolled by this Court. Those purposes can only be frustrated by permitting a State to defraud its citizens under the cloak of Eleventh Amendment immunity.

In the final analysis, defendants' briefs support rather than refute both the legal and equitable bases for federal jurisdiction. Defendants have sold 1,312,128 shares of common stock to 15,372 purchasers. They have received a cash down-payment of $32,803,200. They have saddled plaintiffs with a $375,755,710 mortgage debt. They have sold the stock on the basis of fraudulent information bulletins to the people who most require the protection of the federal securities laws, people of limited means. There should be no exception engrafted upon the relevant statutes for state-sanctioned fraud.

---

[74] *Edelman* involved a conflict between State and federal regulations, the latter having been promulgated while the former were in effect. The State could hardly have anticipated that its actions in administering its regulations might serve, subsequently and retroactively, as the basis of liability because of some implied cause of action. But here there can be no claim that New York was not on actual notice that its actions would result in a waiver of immunity. By the time the State enacted the Mitchell-Lama Act in 1955, and voluntarily went into the business of promoting the public sale of cooperative stock, there was no doubt in anyone's mind that a private party could bring an action under the 1934 Act. Fratt v. Robinson, 203 F.2d 627 (9th Cir. 1953). Indeed, the United States District Court in Baron v. Shields, 131 F. Supp. 370 (S.D. N.Y. 1955), had already held that a state was amenable to suit under Section 10(b) of that Act. In view of these facts, New York and Ohio's implied-cause-of-action argument is not applicable.

CONCLUSION

The antifraud provisions of the federal securities laws were never intended to protect only those who speculate for profit, while leaving exposed those who have invested their entire savings in what is probably the one important stock purchase of their lives—not for speculative gain, but for economic necessity. Over the forty year history of these laws, this Court has steadfastly refused to permit any erosion of their protection of innocent purchasers. In this tradition, the decision of the Court of Appeals should be affirmed.

Dated: New York, New York
April 4, 1975

Respectfully submitted,

LOUIS NIZER
40 West 57th Street
New York, New York 10019
Attorney for Respondents

GEORGE BERGER
JAY F. GORDON
IRA B. ROSE
JANET P. KANE
THOMAS G. JACKSON
Of Counsel